

PRELIMINARY OFFICIAL STATEMENT DATED JUNE 14, 2018

In the opinion of Fryberger, Buchanan, Smith & Frederick, P.A., Bond Counsel, assuming continued compliance with the requirements of the Internal Revenue Code of 1986, as amended (the "Code"), under existing law, interest on the Bonds is not includable in gross income for federal income tax purposes and is not an item of tax preference for purposes of federal alternative minimum tax imposed on individuals. See "TAX EXEMPTION" herein for a more detailed discussion. The interest on the Bonds is exempt from taxable income of individuals, trusts and estates, for Minnesota income tax purposes, but such interest is includable in taxable income of corporations and financial institutions for purposes of the Minnesota franchise tax.

The City will designate the Bonds as "qualified tax-exempt obligations" for purposes of Section 265(b)(3) of the Internal Revenue Code of 1986, as amended, relating to the ability of financial institutions to deduct from income for federal income tax purposes, interest expense that is allocable to carrying and acquiring tax-exempt obligations.

New Issue

Rating Application Made: S&P Global Ratings

CITY OF TWO HARBORS, MINNESOTA (Lake County)

\$2,140,000* GENERAL OBLIGATION BONDS, SERIES 2018A

PROPOSAL OPENING: June 25, 2018, 10:00 A.M., C.T.

CONSIDERATION: June 25, 2018, 6:00 P.M., C.T.

PURPOSE/AUTHORITY/SECURITY: The \$2,140,000* General Obligation Bonds, Series 2018A (the "Bonds") are being issued pursuant to Minnesota Statutes, Chapters 429 and 475, and Sections 410.32, 412.301 and 475.58, by the City of Two Harbors, Minnesota (the "City") for the purpose of financing various public improvements, the acquisition of various capital equipment, and to finance certain street reconstruction projects described in the City's 5-Year Street Reconstruction Plan dated May 14, 2018. The Bonds will be general obligations of the City for which its full faith, credit and taxing powers are pledged. Delivery is subject to receipt of an approving legal opinion of Fryberger, Buchanan, Smith & Frederick, P.A., Duluth, Minnesota.

DATE OF BONDS: July 17, 2018

MATURITY: February 1 as follows:

<u>Year</u>	<u>Amount*</u>	<u>Year</u>	<u>Amount*</u>	<u>Year</u>	<u>Amount*</u>
2020	\$120,000	2025	\$135,000	2030	\$150,000
2021	120,000	2026	140,000	2031	155,000
2022	125,000	2027	145,000	2032	165,000
2023	125,000	2028	140,000	2033	170,000
2024	130,000	2029	145,000	2034	175,000

MATURITY ADJUSTMENTS: * The City reserves the right to increase or decrease the principal amount of the Bonds on the day of sale, in increments of \$5,000 each. Increases or decreases may be made in any maturity. If any principal amounts are adjusted, the purchase price proposed will be adjusted to maintain the same gross spread per \$1,000.

TERM BONDS: See "Term Bond Option" herein.

INTEREST: February 1, 2019 and semiannually thereafter.

OPTIONAL REDEMPTION: Bonds maturing February 1, 2028 and thereafter are subject to call for prior redemption on February 1, 2027 and any date thereafter, at a price of par plus accrued interest.

MINIMUM PROPOSAL: \$2,114,320

GOOD FAITH DEPOSIT: A good faith deposit in the amount of \$42,800 shall be made by the winning bidder by wire transfer of funds.

PAYING AGENT: Bond Trust Services Corporation

BOND COUNSEL: Fryberger, Buchanan, Smith & Frederick, P.A.

MUNICIPAL ADVISOR: Ehlers and Associates, Inc.

BOOK-ENTRY-ONLY: See "Book-Entry-Only System" herein (unless otherwise specified by the purchaser).

This Preliminary Official Statement and the information contained herein are subject to completion and amendment. These securities may not be sold nor may offers to buy be accepted prior to the time the Official Statement is delivered in final form. Under no circumstances shall this Preliminary Official Statement constitute an offer to sell or the solicitation of an offer to buy these securities nor shall there be any sale of these securities in any jurisdiction in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of any such jurisdiction. This Preliminary Official Statement is in a form deemed final as of its date for purposes of SEC Rule 15c2-12(b)(1), but is subject to revision, amendment and completion in a Final Official Statement.



REPRESENTATIONS

No dealer, broker, salesperson or other person has been authorized by the City to give any information or to make any representation other than those contained in this Preliminary Official Statement and, if given or made, such other information or representations must not be relied upon as having been authorized by the City. *This Preliminary Official Statement does not constitute an offer to sell or a solicitation of an offer to buy any of the Bonds in any jurisdiction to any person to whom it is unlawful to make such an offer or solicitation in such jurisdiction.*

This Preliminary Official Statement is not to be construed as a contract with the Syndicate Manager or Syndicate Members. Statements contained herein which involve estimates or matters of opinion are intended solely as such and are not to be construed as representations of fact. Ehlers & Associates, Inc. prepared this Preliminary Official Statement and any addenda thereto relying on information of the City and other sources for which there is reasonable basis for believing the information is accurate and complete. Bond Counsel has not participated in the preparation of this Preliminary Official Statement and is not expressing any opinion as to the completeness or accuracy of the information contained therein. Compensation of Ehlers & Associates, Inc., payable entirely by the City, is contingent upon the sale of the issue.

COMPLIANCE WITH S.E.C. RULE 15c2-12

Certain municipal obligations (issued in an aggregate amount over \$1,000,000) are subject to Rule 15c2-12 promulgated by the Securities and Exchange Commission pursuant to the Securities Exchange Act of 1934, as amended (the "Rule").

Preliminary Official Statement: This Preliminary Official Statement was prepared for the City for dissemination to potential investors. Its primary purpose is to disclose information regarding the Bonds to prospective underwriters in the interest of receiving competitive proposals in accordance with the sale notice contained herein. Unless an addendum is posted prior to the sale, this Preliminary Official Statement shall be deemed nearly final for purposes of the Rule subject to completion, revision and amendment in a Final Official Statement as defined below.

Review Period: This Preliminary Official Statement has been distributed to prospective bidders for review. Comments or requests for the correction of omissions or inaccuracies must be submitted to Ehlers & Associates, Inc. at least two business days prior to the sale. Requests for additional information or corrections in the Preliminary Official Statement received on or before this date will not be considered a qualification of a proposal received from an underwriter. If there are any changes, corrections or additions to the Preliminary Official Statement, interested bidders will be informed by an addendum prior to the sale.

Final Official Statement: Copies of the Final Official Statement will be delivered to the underwriter (Syndicate Manager) within seven business days following the proposal acceptance.

Continuing Disclosure: Subject to certain exemptions, issues in an aggregate amount over \$1,000,000 may be required to comply with provisions of the Rule which require that underwriters obtain from the issuers of municipal securities (or other obligated party) an agreement for the benefit of the owners of the securities to provide continuing disclosure with respect to those securities. This Preliminary Official Statement describes the conditions under which the Bonds are exempt or required to comply with the Rule.

CLOSING CERTIFICATES

Upon delivery of the Bonds, the underwriter (Syndicate Manager) will be furnished with the following items: (1) a certificate of the appropriate officials to the effect that at the time of the sale of the Bonds and all times subsequent thereto up to and including the time of the delivery of the Bonds, this Preliminary Official Statement did not and does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading; (2) a receipt signed by the appropriate officer evidencing payment for the Bonds; (3) a certificate evidencing the due execution of the Bonds, including statements that (a) no litigation of any nature is pending, or to the knowledge of signers, threatened, restraining or enjoining the issuance and delivery of the Bonds, (b) neither the corporate existence or boundaries of the City nor the title of the signers to their respective offices is being contested, and (c) no authority or proceedings for the issuance of the Bonds have been repealed, revoked or rescinded; and (4) a certificate setting forth facts and expectations of the City which indicates that the City does not expect to use the proceeds of the Bonds in a manner that would cause them to be arbitrage bonds within the meaning of Section 148 of the Internal Revenue Code of 1986, as amended, or within the meaning of applicable Treasury Regulations.

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CITY OF TWO HARBORS CITY COUNCIL

		<u>Term Expires</u>
Christopher Swanson	Mayor	January 2021
Robin Glaser	Council Member	January 2021
Jerry Norberg	Council Member	January 2019
Miles Woodruff	Council Member	January 2019
Frank McQuade	Council Member	January 2019
Catherine Erickson	Council Member	January 2021
Craig Jussila	Council Member	January 2021

ADMINISTRATION

Dan Walker, City Administrator

Miranda Pietila, Finance Director

PROFESSIONAL SERVICES

Fryberger, Buchanan, Smith & Frederick, P.A., Bond Counsel, Duluth, Minnesota

Ehlers & Associates, Inc., Municipal Advisors, Roseville, Minnesota
(Other offices located in Waukesha, Wisconsin, Chicago, Illinois and Denver, Colorado)

INTRODUCTORY STATEMENT

This Preliminary Official Statement contains certain information regarding the City of Two Harbors, Minnesota (the "City") and the issuance of its \$2,140,000* General Obligation Bonds, Series 2018A (the "Bonds"). Any descriptions or summaries of the Bonds, statutes, or documents included herein are not intended to be complete and are qualified in their entirety by reference to such statutes and documents and the form of the Bonds to be included in the resolution authorizing the sale of the Bonds ("Award Resolution") to be adopted by the City Council on June 25, 2018.

Inquiries may be directed to Ehlers & Associates, Inc. ("Ehlers" or the "Municipal Advisor"), Roseville, Minnesota, (651) 697-8500, the City's Municipal Advisor. A copy of this Preliminary Official Statement may be downloaded from Ehlers' web site at www.ehlers-inc.com by connecting to the link to the Bond Sales and following the directions at the top of the site.

THE BONDS

GENERAL

The Bonds will be issued in fully registered form as to both principal and interest in denominations of \$5,000 each or any integral multiple thereof, and will be dated, as originally issued, as of July 17, 2018. The Bonds will mature on February 1 in the years and amounts set forth on the cover of this Preliminary Official Statement. Interest will be payable on February 1 and August 1 of each year, commencing February 1, 2019, to the registered owners of the Bonds appearing of record in the bond register as of the close of business on the 15th day (whether or not a business day) of the immediately preceding month. Interest will be computed upon the basis of a 360-day year of twelve 30-day months and will be rounded pursuant to rules of the Municipal Securities Rulemaking Board ("MSRB"). **The rate for any maturity may not be more than 1.00% less than the rate for any preceding maturity. (For example, if a rate of 4.50% is proposed for the 2020 maturity, then the lowest rate that may be proposed for any later maturity is 3.50%).** All Bonds of the same maturity must bear interest from the date of issue until paid at a single, uniform rate. Each rate must be expressed in an integral multiple of 5/100 or 1/8 of 1%.

Unless otherwise specified by the purchaser, the Bonds will be registered in the name of Cede & Co., as nominee for The Depository Trust Company, New York, New York ("DTC"). (See "Book-Entry-Only System" herein.) As long as the Bonds are held under the book-entry system, beneficial ownership interests in the Bonds may be acquired in book-entry form only, and all payments of principal of, premium, if any, and interest on the Bonds shall be made through the facilities of DTC and its participants. If the book-entry system is terminated, principal of, premium, if any, and interest on the Bonds shall be payable as provided in the Award Resolution.

The City has selected Bond Trust Services Corporation, Roseville, Minnesota, to act as paying agent (the "Paying Agent"). Bond Trust Services Corporation and Ehlers are affiliate companies. The City will pay the charges for Paying Agent services. The City reserves the right to remove the Paying Agent and to appoint a successor.

*Preliminary, subject to change.

OPTIONAL REDEMPTION

At the option of the City, the Bonds maturing on or after February 1, 2028 shall be subject to optional redemption prior to maturity on February 1, 2027 and on any date thereafter, at a price of par plus accrued interest.

Redemption may be in whole or in part of the Bonds subject to prepayment. If redemption is in part, the selection of the amounts and maturities of the Bonds to be redeemed shall be at the discretion of the City. If only part of the Bonds having a common maturity date are called for redemption, then the City or Paying Agent, if any, will notify DTC of the particular amount of such maturity to be redeemed. DTC will determine by lot the amount of each participant's interest in such maturity to be redeemed and each participant will then select by lot the beneficial ownership interest in such maturity to be redeemed.

Notice of redemption shall be sent by mail not more than 60 days and not less than 30 days prior to the date fixed for redemption to the registered owner of each Bond to be redeemed at the address shown on the registration books.

AUTHORITY; PURPOSE

The Bonds are being issued pursuant to Minnesota Statutes, Chapters 429 and 475, and Sections 410.32, 412.301 and 475.58, by the City to finance the construction of the 2018 Street and Alley improvements (the "Improvement Portion"); the City's share of the 2018 MnDOT Project including the acquisition and installation of street lights (the "Equipment Portion"), and street reconstruction to the municipal campground entrance (the "Street Reconstruction Plan Portion").

All equipment has an expected useful life at least as long as the term of the Bonds. The par amount of the Equipment Portion of the Bonds does not exceed 0.25% of the estimated market value of taxable property in the City. The estimated market value of taxable property in the City for taxes collectible in 2017 and payable in 2018 is \$236,692,000. Therefore, the maximum par amount of the Equipment Portion of the Bonds cannot exceed \$591,730.

ESTIMATED SOURCES AND USES*

Sources	Improvement Portion	Equipment Portion	Street Reconstruction Portion	Total Bond Issue
Par Amount of Bonds	\$2,010,000	\$40,000	\$90,000	\$2,140,000
Planned Issuer Equity contribution	<u>-</u>	<u>-</u>	<u>10,000</u>	<u>10,000</u>
Total Sources	\$2,010,000	\$40,000	\$100,000	\$2,150,000
Uses				
Total Underwriter's Discount (1.200%)	\$24,120	\$480	\$1,080	\$25,680
Costs of Issuance	46,493	925	2,082	49,500
Deposit to Capitalized Interest (CIF) Fund	28,988	576	1,531	31,095
Deposit to Project Construction Fund	1,909,500	36,796	96,565	2,042,861
Rounding Amount	<u>899</u>	<u>1,223</u>	<u>(1,258)</u>	<u>864</u>
Total Uses	\$2,010,000	\$40,000	\$100,000	\$2,150,000

Breakdown of Principal Payments:

Payment Date	Improvement Portion	Equipment Portion	Street Reconstruction Portion	Total Bond Issue
2/01/2020	\$110,000	\$5,000	\$5,000	\$120,000
2/01/2021	110,000	5,000	5,000	120,000
2/01/2022	115,000	5,000	5,000	125,000
2/01/2023	115,000	5,000	5,000	125,000
2/01/2024	120,000	5,000	5,000	130,000
2/01/2025	125,000	5,000	5,000	135,000
2/01/2026	130,000	5,000	5,000	140,000
2/01/2027	135,000	5,000	5,000	145,000
2/01/2028	135,000	-	5,000	140,000
2/01/2029	140,000	-	5,000	145,000
2/01/2030	145,000	-	5,000	150,000
2/01/2031	150,000	-	5,000	155,000
2/01/2032	155,000	-	10,000	165,000
2/01/2033	160,000	-	10,000	170,000
2/01/2034	<u>165,000</u>	<u>-</u>	<u>10,000</u>	<u>175,000</u>
Total	\$2,010,000	\$40,000	\$90,000	\$2,140,000

*Preliminary, subject to change

SECURITY

The Bonds are general obligations of the City for which its full faith, credit and taxing powers are pledged without limitation as to rate or amount. The City anticipates that the debt service will be paid from a combination of special assessments levied against properties benefitted by improvements financed by the Bonds and from ad valorem property taxes. Receipt of special assessments and collection of ad valorem taxes will be sufficient to provide not less than 105% of principal and interest on the Bonds as required by Minnesota law.

Should the revenues pledged for payment of the Bonds be insufficient to pay the principal and interest as the same shall become due, the City is required to pay maturing principal and interest from moneys on hand in any other fund of the City not pledged for another purpose and/or to levy additional taxes for this purpose upon all the taxable property in the City, without limitation as to rate or amount.

The Bonds will be general obligations of the City for which the City will pledge its full faith, credit and taxing powers. Ad valorem taxes will be levied in an amount sufficient to provide not less than 105% of principal and interest on the Bonds as required by Minnesota law.

RATING

The City currently does not have a bond rating. The City has requested a rating on this issue from S&P Global Ratings ("S&P"), and bidders will be notified as to the assigned rating prior to the sale. Such rating reflects only the views of such organization and explanations of the significance of such rating may be obtained from S&P. Generally, a rating agency bases its rating on the information and materials furnished to it and on investigations, studies and assumptions of its own. There is no assurance that such rating will continue for any given period of time or that it will not be revised downward or withdrawn entirely by such rating agency, if in the judgment of such rating agency circumstances so warrant. Any such downward revision or withdrawal of such rating may have an adverse effect on the market price of the Bonds.

Such rating is not to be construed as a recommendation of the rating agency to buy, sell or hold the Bonds, and the rating assigned by the rating agency should be evaluated independently. Except as may be required by the Disclosure Undertaking described under the heading "CONTINUING DISCLOSURE" neither the City nor the underwriter undertake responsibility to bring to the attention of the owner of the Bonds any proposed changes in or withdrawal of such rating or to oppose any such revision or withdrawal.

CONTINUING DISCLOSURE

In order to assist the Underwriters in complying with SEC Rule 15c2-12 promulgated by the Securities and Exchange Commission, pursuant to the Securities Exchange Act of 1934 (hereinafter the "Rule"), the City shall covenant to take certain actions pursuant to a Resolution adopted by the City Council by entering into a Continuing Disclosure Undertaking (the "Disclosure Undertaking") for the benefit of holders, including beneficial holders. The Disclosure Undertaking requires the City to provide electronically or in the manner otherwise prescribed certain financial information annually and to provide notices of the occurrence of certain events enumerated in the Rule. The details and terms of the Disclosure Undertaking for this issue are set forth in Appendix D to be executed and delivered by the City at the time of delivery of the Bonds. Such Disclosure Undertaking will be in substantially the form attached hereto.

In the previous five years, the City has not had any prior undertakings subject to the Rule.

A failure by the City to comply with any Disclosure Undertaking will not constitute an event of default on this issue or any issue outstanding. However, such a failure may adversely affect the transferability and liquidity of the Bonds and their market price.

The City will file its continuing disclosure information using the Electronic Municipal Market Access ("EMMA") system or any system that may be prescribed in the future. Investors will be able to access continuing disclosure information filed with the MSRB at www.emma.msrb.org.

LEGAL OPINION

An opinion as to the validity of the Bonds and the exemption from taxation of the interest thereon will be furnished by Fryberger, Buchanan, Smith & Frederick, P.A., Duluth, Minnesota, Bond Counsel to the City, and will be available at the time of delivery of the Bonds. The legal opinion will state that the Bonds are valid and binding general obligations of the City; provided that the rights of the owners of the Bonds and the enforceability of the Bonds may be limited by bankruptcy, insolvency, reorganization, moratorium, and other similar laws affecting creditors' rights and by equitable principles (which may be applied in either a legal or equitable proceeding). See "FORM OF LEGAL OPINION" found in Appendix B.

QUALIFIED TAX-EXEMPT OBLIGATIONS

The City will designate the Bonds as "qualified tax-exempt obligations" for purposes of Section 265(b)(3) of the Code relating to the ability of financial institutions to deduct from income for federal income tax purposes, interest expense that is allocable to carrying and acquiring tax-exempt obligations.

MUNICIPAL ADVISOR

Ehlers has served as municipal advisor to the City in connection with the issuance of the Bonds. The Municipal Advisor cannot participate in the underwriting of the Bonds. The financial information included in this Preliminary Official Statement has been compiled by the Municipal Advisor. Such information does not purport to be a review, audit or certified forecast of future events and may not conform with accounting principles applicable to compilations of financial information. Ehlers is not a firm of certified public accountants. Ehlers is registered with the Securities and Exchange Commission and the MSRB as a Municipal Advisor.

MUNICIPAL ADVISOR AFFILIATED COMPANIES

Bond Trust Services Corporation ("BTSC") and Ehlers Investment Partners, LLC ("EIP") are affiliate companies of Ehlers. BTSC is chartered by the State of Minnesota and authorized in Minnesota, Wisconsin, and Illinois to transact the business of a limited purpose trust company. BTSC provides paying agent services to debt issuers. EIP is a Registered Investment Advisor with the Securities and Exchange Commission. EIP assists issuers with the investment of bond proceeds or investing other issuer funds. This includes escrow bidding agent services. Issuers, such as the City, have retained or may retain BTSC and/or EIP to provide these services. If hired, BTSC and/or EIP would be retained by the City under an agreement separate from Ehlers.

INDEPENDENT AUDITORS

The basic financial statements of the City for the fiscal year ended December 31, 2017 have been audited by Bergan KDV Ltd., Minneapolis, Minnesota, independent auditors (the "Auditor"). The report of the Auditor, together with the basic financial statements, component units financial statements, and notes to the financial statements are attached hereto as "APPENDIX A – FINANCIAL STATEMENTS". The Auditor has not been engaged to perform and has not performed, since the date of its report included herein, any procedures on the financial statements addressed in that report. The Auditor also has not performed any procedures relating to this Preliminary Official Statement.

RISK FACTORS

Following is a description of possible risks to holders of the Bonds without weighting as to probability. This description of risks is not intended to be all-inclusive, and there may be other risks not now perceived or listed here.

Taxes: The Bonds are general obligations of the City, the ultimate payment of which rests in the City's ability to levy and collect sufficient taxes to pay debt service should other revenue (special assessments) be insufficient. In the event of delayed billing, collection or distribution of property taxes, sufficient funds may not be available to the City in time to pay debt service when due.

State Actions: Many elements of local government finance, including the issuance of debt and the levy of property taxes, are controlled by state government. Future actions of the state may affect the overall financial condition of the City, the taxable value of property within the City, and the ability of the City to levy and collect property taxes.

Future Changes in Law: Various State and federal laws, regulations and constitutional provisions apply to the City and to the Bonds. The City can give no assurance that there will not be a change in or interpretation of any such applicable laws, regulations and provisions which would have a material effect on the City or the taxing authority of the City.

Ratings; Interest Rates: In the future, the City's credit rating may be reduced or withdrawn, or interest rates for this type of obligation may rise generally, either possibility resulting in a reduction in the value of the Bonds for resale prior to maturity.

Tax Exemption: If the federal government or the State of Minnesota taxes all or a portion of the interest on municipal obligations, directly or indirectly, or if there is a change in federal or state tax policy, the value of the Bonds may fall for purposes of resale. Noncompliance following the issuance of the Bonds with certain requirements of the Code and covenants of the Award Resolution may result in the inclusion of interest on the Bonds in gross income of the recipient for United States income tax purposes or in taxable net income of individuals, estates or trusts for State of Minnesota income tax purposes. No provision has been made for redemption of the Bonds, or for an increase in the interest rate on the Bonds, in the event that interest on the Bonds becomes subject to federal or State of Minnesota income taxation, retroactive to the date of issuance.

Continuing Disclosure: A failure by the City to comply with the Disclosure Undertaking for continuing disclosure (see "CONTINUING DISCLOSURE") will not constitute an event of default on the Bonds. Any such failure must be reported in accordance with the Rule and must be considered by any broker, dealer, or municipal securities dealer before recommending the purchase or sale of the Bonds in the secondary market. Such a failure may adversely affect the transferability and liquidity of the Bonds and their market price.

State Economy; State Aids: State of Minnesota cash flow problems could affect local governments and possibly increase property taxes.

Book-Entry-Only System: The timely credit of payments for principal and interest on the Bonds to the accounts of the Beneficial Owners of the Bonds may be delayed due to the customary practices, standing instructions or for other unknown reasons by DTC participants or indirect participants. Since the notice of redemption or other notices to holders of these obligations will be delivered by the City to DTC only, there may be a delay or failure by DTC, DTC participants or indirect participants to notify the Beneficial Owners of the Bonds.

Economy: A combination of economic, climatic, political or civil disruptions or terrorist actions outside of the control of the City, including loss of major taxpayers or major employers, could affect the local economy and result in reduced tax collections and/or increased demands upon local government. Real or perceived threats to the financial stability of the City may have an adverse effect on the value of the Bonds in the secondary market.

Secondary Market for the Bonds: No assurance can be given that a secondary market will develop for the purchase and sale of the Bonds or, if a secondary market exists, that such Bonds can be sold for any particular price. The underwriters are not obligated to engage in secondary market trading or to repurchase any of the Bonds at the request of the owners thereof. Prices of the Bonds as traded in the secondary market are subject to adjustment upward and downward in response to changes in the credit markets and other prevailing circumstances. No guarantee exists as to the future market value of the Bonds. Such market value could be substantially different from the original purchase price.

Bankruptcy: The rights and remedies of the holders may be limited by and are subject to the provisions of federal bankruptcy laws, to other laws, or equitable principles that may affect the enforcement of creditors' rights, to the exercise of judicial discretion in appropriate cases and to limitations on legal remedies against local governments. The opinion of Bond Counsel to be delivered with respect to the Bonds will be similarly qualified.

VALUATIONS

OVERVIEW

All non-exempt property is subject to taxation by local taxing districts. Exempt real property includes Indian lands, public property, and educational, religious and charitable institutions. Most personal property is exempt from taxation (except investor-owned utility mains, generating plants, etc.).

The valuation of property in Minnesota consists of three elements. (1) The estimated market value is set by city or county assessors. Not less than 20% of all real properties are to be appraised by local assessors each year. (2) The taxable market value is the estimated market value adjusted by all legislative exclusions. (3) The tax capacity (taxable) value of property is determined by class rates set by the State Legislature. The tax capacity rate varies according to the classification of the property. Tax capacity represents a percent of taxable market value.

The property tax rate for a local taxing jurisdiction is determined by dividing the total tax capacity or market value of property within the jurisdiction into the dollars to be raised from the levy. State law determines whether a levy is spread on tax capacity or market value. Major classifications and the percentages by which tax capacity is determined are:

Type of Property	2015/16	2016/17	2017/18
Residential homestead ¹	First \$500,000 - 1.00% Over \$500,000 - 1.25%	First \$500,000 - 1.00% Over \$500,000 - 1.25%	First \$500,000 - 1.00% Over \$500,000 - 1.25%
Agricultural homestead ¹	First \$500,000 HGA - 1.00% Over \$500,000 HGA - 1.25% First \$2,140,000 - 0.50% ² Over \$2,140,000 - 1.00% ²	First \$500,000 HGA - 1.00% Over \$500,000 HGA - 1.25% First \$2,050,000 - 0.50% ² Over \$2,050,000 - 1.00% ²	First \$500,000 HGA - 1.00% Over \$500,000 HGA - 1.25% First \$1,940,000 - 0.50% ² Over \$1,940,000 - 1.00% ²
Agricultural non-homestead	Land - 1.00% ²	Land - 1.00% ²	Land - 1.00% ²
Seasonal recreational residential	First \$500,000 - 1.00% ³ Over \$500,000 - 1.25% ³	First \$500,000 - 1.00% ³ Over \$500,000 - 1.25% ³	First \$500,000 - 1.00% ³ Over \$500,000 - 1.25% ³
Residential non-homestead:	1 unit - 1st \$500,000 - 1.00% Over \$500,000 - 1.25% 2-3 units - 1.25% 4 or more - 1.25% Small City ⁴ - 1.25% Affordable Rental: First \$106,000 - .75% Over \$106,000 - .25%	1 unit - 1st \$500,000 - 1.00% Over \$500,000 - 1.25% 2-3 units - 1.25% 4 or more - 1.25% Small City ⁴ - 1.25% Affordable Rental: First \$115,000 - .75% Over \$115,000 - .25%	1 unit - 1st \$500,000 - 1.00% Over \$500,000 - 1.25% 2-3 units - 1.25% 4 or more - 1.25% Small City ⁴ - 1.25% Affordable Rental: First \$121,000 - .75% Over \$121,000 - .25%
Industrial/Commercial/Utility ⁵	First \$150,000 - 1.50% Over \$150,000 - 2.00%	First \$150,000 - 1.50% Over \$150,000 - 2.00%	First \$150,000 - 1.50% Over \$150,000 - 2.00%

¹ A residential property qualifies as "homestead" if it is occupied by the owner or a relative of the owner on the assessment date.

² Applies to land and buildings. Exempt from referendum market value tax.

³ Exempt from referendum market value tax.

⁴ Cities of 5,000 population or less and located entirely outside the seven-county metropolitan area and the adjacent nine-county area and whose boundaries are 15 miles or more from the boundaries of a Minnesota city with a population of over 5,000.

⁵ The estimated market value of utility property is determined by the Minnesota Department of Revenue.

CURRENT PROPERTY VALUATIONS

2016/17 Economic Market Value¹ \$256,459,765²

	2017/18 Assessor's Estimated Market Value	2017/18 Net Tax Capacity
Real Estate	\$236,686,600	\$ 2,436,320
Personal Property	<u>5,400</u>	<u>81</u>
Total Valuation	<u>\$236,692,000</u>	\$ 2,436,401
Less: Fiscal Disparities Contribution ³		<u>(268,380)</u>
Taxable Net Tax Capacity		\$ 2,168,021
Plus: Fiscal Disparities Distribution ²		<u>285,143</u>
Adjusted Taxable Net Tax Capacity		<u>\$ 2,453,164</u>

¹ Most recent value available from the Minnesota Department of Revenue.

² According to the Minnesota Department of Revenue, the Assessor's Estimated Market Value (the "AEMV") for the City of Two Harbors is about 93.28% of the actual selling prices of property most recently sold in the City. The sales ratio was calculated by comparing the selling prices with the AEMV. Dividing the AEMV of real estate by the sales ratio and adding the AEMV of personal property and utility, railroads and minerals, if any, results in an Economic Market Value ("EMV") for the City of \$256,459,765.

³ Each community in the taconite credit area contributes 40% of the growth in its commercial- industrial property tax base to an area pool which is then distributed among the municipalities on the basis of population, special needs, etc. Each governmental unit makes a contribution and receives a distribution--sometimes gaining and sometimes contributing net tax capacity for tax purposes.

2017/18 NET TAX CAPACITY BY CLASSIFICATION

	2017/18 Net Tax Capacity	Percent of Total Net Tax Capacity
Residential homestead	\$ 1,136,298	46.64%
Commercial/industrial	631,177	25.91%
Railroad operating property	111,924	4.59%
Non-homestead residential	404,167	16.59%
Commercial & residential seasonal/rec.	152,754	6.27%
Personal property	81	0.00%
Total	<u>\$ 2,436,401</u>	<u>100.00%</u>

TREND OF VALUATIONS

Levy Year	Assessor's Estimated Market Value	Assessor's Taxable Market Value	Net Tax Capacity ¹	Adjusted Taxable Net Tax Capacity ²	Percent +/- in Estimated Market Value
2013/14	\$ 215,218,500	\$185,501,800	\$2,169,984	\$ 1,795,495	-0.23%
2014/15	219,079,800	189,528,800	2,219,740	1,835,984	+1.79%
2015/16	219,555,000	189,817,100	2,225,619	1,919,395	+0.22%
2016/17	231,428,700	208,005,085	2,454,377	2,223,174	+5.41%
2017/18	236,692,000	207,619,926	2,436,401	2,453,164	+2.27%

¹ Net Tax Capacity is before fiscal disparities adjustments.

² Adjusted Taxable Net Tax Capacity is after fiscal disparities adjustments.

LARGER TAXPAYERS

Taxpayer	Type of Property	2017/18 Net Tax Capacity	Percent of City's Total Net Tax Capacity
Wisconsin Central Ltd.	Railroad	\$ 120,954	4.96%
Jensen Re Development LLC	Recreational	105,596	4.33%
Lake View Memorial Hospital Inc.	Commercial	56,699	2.33%
Miners Incorporated	Commercial	50,962	2.09%
Ecumen Sunrise LLC	Apartment	46,856	1.92%
Two Harbors First LLC	Commercial	32,760	1.34%
Kwik Trip Inc.	Commercial	26,809	1.10%
Two Harbors Lodge LLC	Commercial	24,806	1.02%
Innsight Hospitality LLC	Commercial	23,266	0.95%
2H Living Inc.	Apartment	28,163	1.16%
Total		<u><u>\$516,871</u></u>	<u><u>21.21%</u></u>

City's Total 2017/18 Net Tax Capacity \$2,436,401

Source: Current Property Valuations, Net Tax Capacity by Classification, Trend of Valuations and Larger Taxpayers have been furnished by Lake County.

DEBT

DIRECT DEBT¹

General Obligation Debt (see schedules following)

Total g.o. debt being paid from public utility revenues	\$7,701,600
Total g.o. debt being paid from taxes	125,625
Total g.o. debt being paid from special assessments and taxes (includes the Bonds)*	<u>2,140,000</u>
Total General Obligation Debt*	<u><u>\$9,967,225</u></u>

*Preliminary, subject to change.

¹ Outstanding debt is as of the dated date of the Bonds.

CITY OF TWO HARBORS, MINNESOTA
Schedule of Bonded Indebtedness
General Obligation Debt Being Paid From Public Utility Revenues
(As of 7/17/15)

Fiscal Year Ending	MPFA Loan 1999		Water Supply Control 2008		MPFA Loan 2009		MPFA Loan 2010		MPFA Loan 2014		MPFA Loan 2015		Total P & I	Principal Outstanding	% Paid	Fiscal Year Ending
	Dated Amount	Maturity	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest				
2018	6/30/99	8/20	55,000	1,702	104,000	18,240	114,000	12,463	7,100	448	223,000	21,900	561,553	7,178,500	6.79%	2016
2019	8/30/99	8/20	57,000	1,733	107,000	33,590	116,000	23,022	7,100	925	230,000	41,370	600,272	6,925,400	13.81%	2019
2020					110,000	31,164	119,000	21,816	7,100	925	230,000	41,370	594,636	6,425,000	21.51%	2020
2021					113,000	28,364	119,000	19,131	7,300	692	230,000	37,030	592,390	5,613,800	27.12%	2021
2022					115,000	25,508	123,000	17,150	7,400	609	232,000	34,730	594,636	5,097,500	53.81%	2022
2023					118,000	22,800	123,000	15,135	7,400	535	235,000	32,410	554,080	4,614,100	40.09%	2023
2024					121,000	19,617	126,000	13,087	7,500	461	237,000	30,060	554,725	4,122,600	46.47%	2024
2025					124,000	16,558	126,000	10,989	7,600	386	239,000	27,690	554,223	3,624,000	52.94%	2025
2026					128,000	13,424	130,000	8,658	7,600	310	242,000	25,300	555,491	3,116,400	59.54%	2026
2027					131,000	10,188	132,000	6,693	7,700	234	244,000	22,880	554,695	2,601,700	66.22%	2027
2028					134,000	6,876	134,000	4,496	7,800	157	247,000	20,440	552,800	2,078,900	73.01%	2028
2029					138,000	3,489	136,000	2,284	7,900	79	249,000	17,970	554,702	1,548,000	79.90%	2029
2030											252,000	15,480	554,702	1,018,000	83.17%	2030
2031											254,000	12,960	554,702	468,000	86.47%	2031
2032											257,000	10,420	554,702	185,000	89.81%	2032
2033											259,000	7,850	554,702	526,000	93.17%	2033
2034											262,000	5,280	554,702	264,000	96.57%	2034
2035											264,000	2,640	554,702	0	100.00%	2035
			112,000	3,435	1,443,000	229,858	1,497,000	154,387	88,600	5,480	4,380,000	405,900	8,519,192			

CITY OF TWO HARBORS, MINNESOTA
Schedule of Bonded Indebtedness
General Obligation Debt Being Paid From Taxes
(As of 7/17/18)

Equipment Note
Series 2012A

Dated Amount	4/19/12 \$783,263	Maturity	3/1 & 9/1	Total Principal	Total Interest	Total P & I	Principal Outstanding	% Paid	Fiscal Year Ending
2018	62,160	2,638	64,798	62,160	2,638	64,798	63,465	49.48%	2018
2019	63,465	1,333	64,798	63,465	1,333	64,798	0	100.00%	2019
	125,625	3,971	129,596	125,625	3,971	129,596			

CITY OF TWO HARBORS, MINNESOTA
Schedule of Bonded Indebtedness
General Obligation Debt Being Paid From Special Assessments and Taxes
(As of 7/17/18)

G.O. Bonds
Series 2018A

Fiscal Year Ending	Dated Amount	Maturity	Estimated Interest		Total Principal	Total Interest	Total P & I	Principal Outstanding	% Paid	Fiscal Year Ending
			Principal	Interest						
2019	7/15/18	2/1			0	68,879	68,879	2,140,000	0.00%	2019
2020	\$2,140,000*		120,000	64,658	120,000	64,658	184,658	2,020,000	5.61%	2020
2021			120,000	61,988	120,000	61,988	181,988	1,900,000	11.21%	2021
2022			125,000	59,076	125,000	59,076	184,076	1,775,000	17.06%	2022
2023			125,000	55,920	125,000	55,920	180,920	1,650,000	22.90%	2023
2024			130,000	52,540	130,000	52,540	182,540	1,520,000	28.97%	2024
2025			135,000	48,861	135,000	48,861	183,861	1,385,000	35.28%	2025
2026			140,000	44,838	140,000	44,838	184,838	1,245,000	41.82%	2026
2027			145,000	40,490	145,000	40,490	185,490	1,100,000	48.60%	2027
2028			140,000	36,003	140,000	36,003	176,003	960,000	55.14%	2028
2029			145,000	31,370	145,000	31,370	176,370	815,000	61.92%	2029
2030			150,000	26,428	150,000	26,428	176,428	665,000	68.93%	2030
2031			155,000	21,165	155,000	21,165	176,165	510,000	76.17%	2031
2032			165,000	15,524	165,000	15,524	180,524	345,000	83.88%	2032
2033			170,000	9,535	170,000	9,535	179,535	175,000	91.82%	2033
2034			175,000	3,238	175,000	3,238	178,238	0	100.00%	2034
			2,140,000	640,510	2,140,000	640,510	2,780,510			

*Preliminary, subject to change.

DEBT LIMIT

The statutory limit on debt of Minnesota municipalities other than school districts or cities of the first class (Minnesota Statutes, Section 475.53, subd. 1) is 3% of the Assessor's Estimated Market Value of all taxable property within its boundaries. "Net debt" (Minnesota Statutes, Section 475.51, subd. 4) is the amount remaining after deducting from gross debt: (1) obligations payable wholly or partly from special assessments levied against benefitted property (includes the Improvement portion of the Bonds); (2) warrants or orders having no definite or fixed maturity; (3) obligations issued to finance any public revenue producing convenience; (4) obligations issued to create or maintain a permanent improvement revolving fund; (5) funds held as sinking funds for payment of principal and interest on debt other than those deductible under 1-4 above; and (6) other obligations which are not to be included in computing the net debt of a municipality under the provisions of the law authorizing their issuance.

2017/18 Assessor's Estimated Market Value	\$ 236,692,000
Multiply by 3%	<u>0.03</u>
Statutory Debt Limit	\$ 7,100,760
Less: Long-Term Debt Outstanding Being Paid Solely from Taxes (includes the Equipment and Street Reconstruction portions of the Bonds)*	<u>(265,625)</u>
Unused Debt Limit*	<u><u>\$ 6,835,135</u></u>

*Preliminary, subject to change.

OVERLAPPING DEBT¹

Taxing District	2017/18 Taxable Net Tax Capacity	% In City	Total G.O. Debt ²	City's Proportionate Share
Lake County	\$17,455,935	12.4200%	\$11,670,000 ³	\$ 1,449,414
I.S.D. No. 381 (Lake Superior)	21,224,314	10.2148%	18,265,000	<u>1,865,733</u>
City's Share of Total Overlapping Debt				<u><u>\$3,315,147</u></u>

¹ Overlapping debt is as of the dated date of the Bonds. Only those taxing jurisdictions with general obligation debt outstanding are included in this section. Does *not* include non-general obligation debt, self-supporting general obligation revenue debt, short-term general obligation debt, or general obligation tax/aid anticipation certificates of indebtedness.

² Outstanding debt is based on information in Official Statements obtained on EMMA and the Municipal Advisor's records.

³ Includes approximately \$2,765,000 General Obligation Capital Improvement Bonds, Series 2018, which are scheduled to close July 18, 2018.

DEBT RATIOS

	G.O. Debt	Debt/Economic Market Value (\$256,459,765)	Debt/ Current Population Estimate (3,608)
Direct G.O. Debt Being Paid From:			
Public Utility Revenues	\$ 7,701,600		
Taxes	125,625		
Special Assessments & Taxes*	<u>2,140,000</u>		
Total General Obligation Debt (includes the Bonds)*	\$ 9,967,225		
Less: G.O. Debt Paid Entirely from Revenues ¹	<u>(7,701,600)</u>		
Tax Supported General Obligation Debt*	\$ 2,265,625	0.88%	\$627.94
 City's Share of Total Overlapping Debt	 <u>\$ 3,315,147</u>	 <u>1.29%</u>	 <u>\$918.83</u>
 Total*	 <u><u>\$ 5,580,772</u></u>	 <u><u>2.18%</u></u>	 <u><u>\$1,546.78</u></u>

*Preliminary, subject to change.

DEBT PAYMENT HISTORY

The City has no record of default in the payment of principal and interest on its debt.

FUTURE FINANCING

The City has no current plans for additional financing in the next 12 months.

¹ Debt service on the City's general obligation revenue debt is being paid entirely from revenues and therefore is considered self-supporting debt.

TAX RATES, LEVIES AND COLLECTIONS

TAX LEVIES AND COLLECTIONS

Tax Year	Net Tax Levy ¹	Total Collected Following Year	Collected to Date ²	% Collected
2013/14	\$ 1,318,592	\$ 1,267,577	\$ 1,319,837	100.09%
2014/15	1,326,245	1,281,292	1,327,905	100.13%
2015/16	1,400,555	1,353,576	1,394,624	99.58%
2016/17	1,532,372	1,498,256	1,503,275	98.10%
2017/18	1,667,742	In process of collection		

Property taxes are collected in two installments in Minnesota--the first by May 15 and the second by October 15.³ Mobile home taxes are collectible in full by August 31. Minnesota Statutes require that levies (taxes and special assessments) for debt service be at least 105% of the actual debt service requirements to allow for delinquencies.

TAX CAPACITY RATES⁴

	2013/14	2014/15	2015/16	2016/17	2017/18
Lake County	48.121%	52.218%	53.927%	54.067%	56.618%
City of Two Harbors	74.776%	71.728%	72.134%	67.280%	76.042%
I.S.D. No. 381 (Lake Superior)	18.180%	18.217%	17.218%	16.315%	16.292%
ARDC	0.175%	0.174%	0.177%	0.167%	0.177%
Lake County HRA	0.707%	0.702%	0.703%	0.664%	0.665%
Regional Rail Authority	0.791%	0.788%	0.754%	0.747%	0.814%

Referendum Market Value Rates:

I.S.D. No. 381 (Lake Superior)	0.04771%	0.10458%	0.08231%	0.09731%	0.10086%
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Source: Tax Levies and Collections and Tax Capacity Rates have been furnished by Lake County.

¹ This reflects the Final Levy Certification of the City after all adjustments have been made.

² Collections are through May 15, 2018

³ Second half tax payments on agricultural property are due on November 15th of each year.

⁴ After reduction for state aids. Does not include the statewide general property tax against commercial/industrial, non-homestead resorts and seasonal recreational residential property.

LEVY LIMITS

The State Legislature has periodically imposed limitations on the ability of municipalities to levy property taxes. For taxes levied in 2013, payable in 2014, only, the Legislature imposed a one year levy limit on all counties with a population greater than 5,000, and all cities with a population greater than 2,500. While these limitations have expired, the potential exists for future legislation to limit the ability of local governments to levy property taxes. All previous limitations have not limited the ability to levy for the payment of debt service on bonded indebtedness. For more detailed information about Minnesota levy limits, contact the Minnesota Department of Revenue or Ehlers & Associates.

THE ISSUER

CITY GOVERNMENT

The City of Two Harbors was organized as a municipality in 1907. The City operates under a home rule charter form of government consisting of a seven-member City Council of which the Mayor is a voting member. The City Administrator and Finance Director are responsible for administrative details and financial records.

EMPLOYEES; PENSIONS; UNIONS

The City currently has 52 full-time, 8 part-time, and 47 seasonal employees. All full-time and certain part-time employees of the City are covered by defined benefit pension plans administered by the Public Employee Retirement Association of Minnesota (PERA). PERA administers the General Employees Retirement Fund (GERF) and the Public Employees Police and Fire Fund (PEPFF) which are cost-sharing multiple-employer retirement plans. PERA members belong to either the Coordinated Plan or the Basic Plan. Coordinated members are covered by Social Security. See the Notes to Financial Statements in Appendix A for a detailed description of the Plans.

Recognized and Certified Bargaining Units

Bargaining Unit	Expiration Date of Current Contract
AFSCME Local 1123	December 31, 2019
IBEW Local No. 31	December 31, 2019
Teamsters General Local Union No. 346	December 31, 2019
Supervisory Employees Association	December 31, 2019
Confidential Employees Association	December 31, 2019

POST EMPLOYMENT BENEFITS

The City has obligations for some post-employment benefits (some mandated by State Statute and others that cover a portion of the cost of health insurance during retirement) for the majority of its employees. Accounting for these obligations is dictated by Governmental Accounting Standards Board Statement No. 45 (GASB 45). The City has completed an actuarial study of its obligations. The study shows an actuarial accrued liability of \$2,478,745 with a discount rate of 3.5% as of January 1, 2015. The City is currently funding these obligations on a pay-as-you-go basis.

LITIGATION

There is no litigation threatened or pending questioning the organization or boundaries of the City or the right of any of its officers to their respective offices or in any manner questioning their rights and power to execute and deliver the Bonds or otherwise questioning the validity of the Bonds.

MUNICIPAL BANKRUPTCY

Municipalities are prohibited from filing for bankruptcy under Chapter 11 (reorganization) or Chapter 7 (liquidation) of the U.S. Bankruptcy Code (11 U.S.C. §§ 101-1532) (the "Bankruptcy Code"). Instead, the Bankruptcy Code permits municipalities to file a petition under Chapter 9 of the Bankruptcy Code, but only if certain requirements are met. These requirements include that the municipality must be "specifically authorized" under State law to file for relief under Chapter 9. For these purposes, "State law" may include, without limitation, statutes of general applicability enacted by the State legislature, special legislation applicable to a particular municipality, and/or executive orders issued by an appropriate officer of the State's executive branch.

As of the date hereof, Minnesota Statutes, 471.831, authorizes municipalities to file for bankruptcy relief under Chapter 9 of the Bankruptcy Code. A municipality is defined in United States Code, title 11, section 101, as amended through December 31, 1996, but limited to a county, statutory or home rule charter city, or town; or a housing and redevelopment authority, economic development authority, or rural development financing authority established under Chapter 469, a home rule charter or special law.

FUNDS ON HAND (As of May 22, 2018)

Fund	Total Cash and Investments
General	\$ 826,203
Special Revenue	1,059,042
Capital Projects	406,530
Enterprise Funds	16,762,630
Total Funds on Hand	<u><u>\$19,054,405</u></u>

ENTERPRISE FUNDS

Revenues available for debt service on the City's enterprise funds have been as follows as of December 31 each year:

	2015	2016	2017
Water¹			
Total Operating Revenues	\$ 944,485	\$ 1,066,872	\$ 1,083,952
Less: Operating Expenses	<u>(1,277,694)</u>	<u>(1,226,106)</u>	<u>(1,279,529)</u>
Operating Income	\$ (333,209)	\$ (159,234)	\$ (195,577)
Plus: Depreciation	<u>261,306</u>	<u>256,834</u>	<u>384,863</u>
Revenues Available for Debt Service	<u><u>\$ (71,903)</u></u>	<u><u>\$ 97,600</u></u>	<u><u>\$ 189,286</u></u>
Sewer¹			
Total Operating Revenues	\$1,038,977	\$ 1,007,598	\$ 1,134,641
Less: Operating Expenses	<u>(1,241,140)</u>	<u>(1,291,341)</u>	<u>(1,354,228)</u>
Operating Income	\$ (202,163)	\$ (283,743)	\$ (219,587)
Plus: Depreciation	<u>328,414</u>	<u>379,839</u>	<u>375,596</u>
Revenues Available for Debt Service	<u><u>\$ 126,251</u></u>	<u><u>\$ 96,096</u></u>	<u><u>\$ 156,009</u></u>
Electric			
Total Operating Revenues	\$ 1,822,418	\$ 1,963,189	\$ 1,997,799
Less: Operating Expenses	<u>(942,597)</u>	<u>(1,005,936)</u>	<u>(895,517)</u>
Operating Income	\$ 879,821	\$ 957,253	\$ 1,102,282
Plus: Depreciation	<u>158,562</u>	<u>140,684</u>	<u>121,965</u>
Revenues Available for Debt Service	<u><u>\$ 1,038,383</u></u>	<u><u>\$ 1,097,937</u></u>	<u><u>\$ 1,224,247</u></u>
Gas			
Total Operating Revenues	\$ 745,332	\$ 610,330	\$ 653,058
Less: Operating Expenses	<u>(649,940)</u>	<u>(713,206)</u>	<u>(695,137)</u>
Operating Income	\$ 95,392	\$ (102,876)	\$ (42,079)
Plus: Depreciation	<u>76,270</u>	<u>67,693</u>	<u>70,156</u>
Revenues Available for Debt Service	<u><u>\$ 171,662</u></u>	<u><u>\$ (35,183)</u></u>	<u><u>\$ 28,077</u></u>

¹ In addition to the revenues shown, the City makes annual, planned contributions to the Water and Sewer funds from its Local Sales Tax Fund.

ENTERPRISE FUNDS - continued

	2015	2016	2017
Municipal Liquor Store			
Total Operating Revenues	\$ 554,096	\$ 637,780	\$ 651,322
Less: Operating Expenses	<u>(361,984)</u>	<u>(394,862)</u>	<u>(456,419)</u>
Operating Income	\$ 192,112	\$ 242,918	\$ 194,903
Plus: Depreciation	<u>5,876</u>	<u>6,361</u>	<u>7,514</u>
Revenues Available for Debt Service	<u><u>\$ 197,988</u></u>	<u><u>\$ 249,279</u></u>	<u><u>\$ 202,417</u></u>
Stormwater			
Total Operating Revenues	\$ 83,000	\$ 81,312	\$ 83,029
Less: Operating Expenses	<u>(39,581)</u>	<u>(32,010)</u>	<u>(36,152)</u>
Operating Income	\$ 43,419	\$ 49,302	\$ 46,877
Plus: Depreciation	<u>25,363</u>	<u>25,628</u>	<u>25,628</u>
Revenues Available for Debt Service	<u><u>\$ 68,782</u></u>	<u><u>\$ 74,930</u></u>	<u><u>\$ 72,505</u></u>
Campground¹			
Total Operating Revenues	N/A	\$ 531,557	\$ 557,542
Less: Operating Expenses	<u>N/A</u>	<u>(175,426)</u>	<u>(234,519)</u>
Operating Income	N/A	\$ 356,131	\$ 323,023
Plus: Depreciation	<u>N/A</u>	<u>24,842</u>	<u>37,406</u>
Revenues Available for Debt Service	<u><u>N/A</u></u>	<u><u>\$ 380,973</u></u>	<u><u>\$ 360,429</u></u>

¹ For the year ended December 31, 2016, the City reclassified the Campground operations from a governmental activity to a business-type activity.

SUMMARY GENERAL FUND INFORMATION

Following are summaries of the revenues and expenditures and fund balances for the City's General Fund. These summaries are not purported to be the complete audited financial statements of the City, and potential purchasers should read the included financial statements in their entirety for more complete information concerning the City. Copies of the complete statements are available upon request. Appendix A includes the City's 2017 audited financial statements.

COMBINED STATEMENT	FISCAL YEAR ENDING DECEMBER 31				
	2014 Audited	2015 Audited	2016 Audited	2017 Audited	2018 Adopted Budget ¹
Revenues					
Property taxes	\$ 1,226,472	\$ 1,223,199	\$ 1,264,969	\$ 1,358,036	\$ 1,879,662
Licenses and permits	39,156	55,114	54,130	38,548	40,206
Intergovernmental	1,939,519	2,032,371	2,009,920	2,033,620	1,768,079
Charges for services	654,246	704,248	232,475	217,077	197,177
Fines and forfeitures	15,300	11,277	14,125	17,591	14,266
Investment income	3,929	3,466	5,613	6,656	5,669
Special Assessments	15,056	17,270	8,640	11,319	0
Other	21,347	17,737	21,839	13,006	44,543
Total Revenues	\$ 3,915,025	\$ 4,064,682	\$ 3,611,711	\$ 3,695,853	\$ 3,949,602
Expenditures					
Current:					
General government	\$ 662,953	\$ 597,390	\$ 614,179	\$ 553,873	\$ 699,301
Public safety	1,106,246	1,095,428	1,146,588	1,213,432	1,288,262
Public works	936,032	1,009,374	1,038,742	1,089,538	1,181,534
Culture and recreation	216,988	243,164	131,844	186,541	229,308
Health and welfare	81,700	98,879	92,126	91,135	103,355
Miscellaneous	170,266	257,373	215,755	217,248	256,144
Debt service	129,524	129,595	129,596	129,597	129,597
Capital outlay	148,353	242,664	17,767	52,487	0
Total Expenditures	\$ 3,452,062	\$ 3,673,867	\$ 3,386,597	\$ 3,533,851	\$ 3,887,501
Excess of revenues over (under) expenditures	\$ 462,963	\$ 390,815	\$ 225,114	\$ 162,002	\$ 62,101
Other Financing Sources (Uses)					
Proceeds from sale of capital assets	\$ 2,928	\$ 1,991	\$ 0	\$ 12,451	\$ 0
Insurance proceeds	0	0	0	50,724	0
Operating transfers in	205,167	172,671	290,113	376,470	354,115
Operating transfers out	(302,973)	(266,273)	(366,180)	(478,619)	(575,991)
Total Other Financing Sources (Uses)	\$ (94,878)	\$ (91,611)	\$ (76,067)	\$ (38,974)	\$ (221,876)
Net Changes in Fund Balances	\$ 368,085	\$ 299,204	\$ 149,047	\$ 123,028	\$ (159,775)
General Fund Balance January 1	1,043,000	1,411,085	1,710,289	1,859,336	
Prior Period Adjustment	0	0	0	0	
Residual Equity Transfer in (out)	0	0	0	0	
General Fund Balance December 31	\$ 1,411,085	\$ 1,710,289	\$ 1,859,336	\$ 1,982,364	
DETAILS OF DECEMBER 31 FUND BALANCE					
Nonspendable	\$ 0	\$ 0	\$ 0	\$ 0	
Assigned	7,292	3,694	6,779	11,194	
Unassigned	1,403,793	1,706,595	1,852,557	1,971,170	
Total	\$ 1,411,085	\$ 1,710,289	\$ 1,859,336	\$ 1,982,364	

¹ The 2018 budget was adopted on December 19, 2017. At the end of 2017, the City spent down the fund balance by making a larger transfer out to the Capital Equipment fund in 2018. Additionally, the City will not fill the City Planner position, which was originally budgeted, until 2019 decreasing the deficit by approximately \$64,000.

GENERAL INFORMATION

LOCATION

The City of Two Harbors, with a 2010 U.S. Census population of 3,745 and a current population estimate of 3,608, and comprising an area of 3.30 square miles, is located approximately 20 miles northeast of the City of Duluth.

LARGER EMPLOYERS¹

Larger employers in the City of Two Harbors include the following:

Firm	Type of Business/Product	Estimated No. of Employees
Two Harbors Outpatient-Clinic	Clinic	170
Labounty Manufacturing, Inc.	Cutting tools & machine tool accessory manufacturing	160
Lake County	Government municipal and services	149
Louisiana-Pacific Corp.	Building materials	108
Two Harbors Machine Shop, Inc.	Machine shop	100
Lake View Memorial Hospital	Hospital	93
Larsmont Cottages	Cottages, cabins & restaurant	80
Ecumen Nursing Home	Residential home care	78
Northshore Manufacturing, Inc.	Steel-structural manufacturer	75
Splashing Rock Restaurant	Full-service restaurant and banquet rooms	70
Builtrite Handlers-Attachments	Recycling equipment manufacturer	60

Source: *ReferenceUSA, written and telephone survey (May 2018), and the Minnesota Department of Employment and Economic Development.*

¹ This does not purport to be a comprehensive list and is based on available data obtained through a survey of individual employers, as well as the sources identified above. Some employers do not respond to inquiries for employment data.

BUILDING PERMITS

	2014	2015	2016	2017	2018 ¹
<u>New Single Family Homes</u>					
No. of building permits	1	1	4	2	2
Valuation	\$146,235	\$132,720	\$645,410	\$381,850	\$350,700
<u>New Multiple Family Buildings</u>					
No. of building permits	0	0	0	0	0
Valuation	\$0	\$0	\$0	\$0	\$0
<u>New Commercial/Industrial</u>					
No. of building permits	1	3	1	1	0
Valuation	\$714,000	\$2,619,000	\$739,896	\$94,000	\$0
<u>All Building Permits</u> <i>(including additions and remodelings)</i>					
No. of building permits	74	91	81	76	27
Valuation	\$1,909,956	\$3,702,256	\$2,988,195	\$1,986,711	\$2,600,481

Source: The City.

¹ As of May 22, 2018.

U.S. CENSUS DATA

Population Trend: City of Two Harbors, Minnesota

2000 U.S. Census population	3,613
2010 U.S. Census population	3,745
2016 State Demographer's Estimate	3,608
Percent of Change 2000 - 2010	+ 3.65%

Income and Age Statistics

	City of Two Harbors	Lake County	State of Minnesota	United States
2016 per capita income	\$25,723	\$31,215	\$33,225	\$29,826
2016 median household income	\$48,169	\$52,320	\$63,217	\$55,322
2016 median family income	\$55,231	\$65,694	\$79,595	\$67,871
2016 median gross rent	\$689	\$690	\$873	\$928
2016 median value owner occupied units	\$141,100	\$164,700	\$191,500	\$184,700
2016 median age	39.2 yrs.	50.4 yrs.	37.8 yrs.	37.7 yrs.

	State of Minnesota	United States
City % of 2016 per capita income	77.42%	86.24%
City % of 2016 median family income	69.39%	81.38%

Housing Statistics

	<u>City of Two Harbors</u>		Percent of Change
	2000	2016	
All Housing Units	1,631	1,839	12.75%

Source: 2000 and 2010 Census of Population and Housing, and 2016 American Community Survey (Based on a five-year estimate), U.S. Census Bureau (www.factfinder2.census.gov).

EMPLOYMENT/UNEMPLOYMENT DATA

Rates are not compiled for individual communities within counties.

Year	<u>Average Employment</u>		<u>Average Unemployment</u>	
	Lake County	Lake County	Lake County	State of Minnesota
2014	5,399	4.6%	4.2%	
2015	5,300	4.8%	3.7%	
2016	5,026	6.5%	3.8%	
2017	5,031	4.3%	3.5%	
2018, April	5,495	3.2%	3.1%	

Source: Minnesota Department of Employment and Economic Development.

FINANCIAL STATEMENTS

Potential purchasers should read the included financial statements in their entirety for more complete information concerning the City's financial position. Such financial statements have been audited by the Auditor, to the extent and for the periods indicated thereon. The City has not requested the Auditor to perform any additional examination, assessments or evaluation with respect to such financial statements since the date thereof, nor has the City requested that the Auditor consent to the use of such financial statements in this Official Statement. Although the inclusion of the financial statements in this Official Statement is not intended to demonstrate the fiscal condition of the City since the date of the financial statements, in connection with the issuance of the Bonds, the City represents that there have been no material adverse change in the financial position or results of operations of the City, nor has the City incurred any material liabilities, which would make such financial statements misleading.

Copies of the complete audited financial statements for the past three years and the current budget are available upon request from Ehlers.

**City of Two Harbors
Lake County, Minnesota**

Financial Statements

December 31, 2017



Independent Auditor's Report

Honorable Mayor and Members
of the City Council
City of Two Harbors
Two Harbors, Minnesota

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Two Harbors, Minnesota, as of and for the year ended December 31, 2017, and the related notes to financial statements, which collectively comprise the City's basic financial statements as listed in the Table of Contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the City's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.



Auditor's Responsibility (Continued)

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Two Harbors, Minnesota, as of December 31, 2017, and the respective changes in financial position and where applicable, cash flows thereof, and the respective budgetary comparison for the General Fund and Golf Special Revenue Fund for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis, which follows this report letter, and other Required Supplementary Information as listed in the Table of Contents be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board (GASB) who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the Required Supplementary Information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Two Harbors' basic financial statements. The Supplementary Information as listed in the Table of Contents is presented for purposes of additional analysis and is not a required part of the basic financial statements.



Other Matters (Continued)

Other Information (Continued)

The Supplementary Information as listed in the Table of Contents is the responsibility of management, and were derived from, and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Supplementary Information as listed in the Table of Contents is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated April 16, 2018, on our consideration of the City's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the City's internal control over financial reporting and compliance.

BergankDV Ltd.

Minneapolis, Minnesota
April 16 2018

**City of Two Harbors
Management's Discussion and Analysis**

GOVERNMENT-WIDE FINANCIAL STATEMENTS (CONTINUED)

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

Both of the government-wide financial statements distinguish functions of the City that are principally supported by taxes and intergovernmental revenues (governmental activities) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (business-type activities). The governmental activities of the City include general government, public safety, public works, culture and recreation, health and welfare, economic development, and airport. The business-type activities of the City include water, sewer, electric, gas, municipal liquor, stormwater and the campground.

The government-wide financial statements include the City and its two component units, Two Harbors Development Fund and the Two Harbors Economic Development Authority.

The government-wide financial statements can be found on pages 19-21 of this report.

FUND FINANCIAL STATEMENTS

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

Governmental Funds

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

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements.

By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund Balance Sheet and the governmental fund Statement of Revenues, Expenditures, and Changes in Fund Balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

**City of Two Harbors
Management's Discussion and Analysis**

Management of the City of Two Harbors (the "City") has prepared this narrative and analysis of the financial activities of the City for the year ended December 31, 2017 to assist users of this report to gain a better understanding of the City's financial health and history. The information presented in this section should be considered in conjunction with that presented in the notes to financial statements.

FINANCIAL HIGHLIGHTS

- The total net position of the City was \$41,848,847 as of December 31, 2017. The net position of the governmental activities was \$10,718,907. The net position of the business-type activities was \$31,129,940.
- The City's governmental funds reported a total combined ending fund balance of \$3,031,712, a increase of \$153,419 from 2016.
- The General Fund unassigned fund balance was \$1,971,170 or 55.8% of total General Fund expenditures for 2017, compared to \$1,852,557 or 54.7% for 2016.
- The Proprietary Fund unrestricted net position was \$14,698,750 or 298% of total Proprietary Fund operating expenses for 2017, compared to \$13,748,493, or 284% of the same for 2016.
- The City's total debt decreased by \$591,404 during the current year. This represents scheduled payments of the City's debt.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the City's basic financial statements. The City's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

GOVERNMENT-WIDE FINANCIAL STATEMENTS

The government-wide financial statements are designed to provide readers with a broad overview of the City's finances, in a manner similar to a private-sector business.

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

**City of Two Harbors
Management's Discussion and Analysis**

OTHER INFORMATION

The combining statements referred to earlier in connection with nonmajor governmental funds can be found on pages 84-87 of this report.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Statement of Net Position

As noted earlier, net position may serve over time as a useful indicator of a government's financial position. In the case of the City assets and deferred outflows of resources exceeded liability and deferred inflows of resources by \$41,848,847 at the close of the year.

Of the City's total net position, 33% is unrestricted, 3% is restricted, and another 64% reflects the City's investment in capital assets (e.g. land, buildings, machinery, and equipment); less any related debt used to acquire those assets that is still outstanding. The City uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the City's investment in its capital assets is reported net of related debt, it should be noted the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities. A portion of the City's net position (3%) represents resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net position (\$13,935,596) may be used to meet the government's ongoing obligations to citizens and creditors.

	Governmental activities			Business-type activities			Total	
	2017	2016	2017	2016	2017	2016	2017	2016
Assets								
Current and other assets	\$ 3,699,779	\$ 3,475,184	\$ 17,656,370	\$ 16,970,036	\$ 21,356,349	\$ 20,443,210	\$ 42,712,689	\$ 40,886,420
Capital assets	10,537,279	10,401,923	24,670,534	25,136,083	35,207,813	35,538,006	45,740,492	45,976,216
Total assets	\$ 14,237,058	\$ 13,877,107	\$ 42,327,104	\$ 42,106,119	\$ 56,564,162	\$ 55,981,216	\$ 88,453,181	\$ 86,857,636
Deferred Outflows of Resources								
Related to Fire Retiree Pensions	\$ 104,786	\$ 123,228	\$ -	\$ -	\$ 104,786	\$ 123,228	\$ 209,572	\$ 246,456
Related to City Pensions	1,331,252	2,191,144	417,270	888,296	1,748,532	3,079,440	3,089,804	3,968,900
Total deferred outflows of resources	\$ 1,436,038	\$ 2,314,372	\$ 417,270	\$ 888,296	\$ 1,853,308	\$ 3,202,668	\$ 6,179,376	\$ 7,175,364
Liabilities								
Long-term liabilities outstanding	\$ 2,914,570	\$ 4,844,713	\$ 10,357,323	\$ 11,317,452	\$ 13,271,893	\$ 16,162,165	\$ 23,629,266	\$ 27,144,320
Other liabilities	465,922	446,789	904,892	1,348,200	1,370,814	1,794,989	2,323,906	2,989,309
Total liabilities	\$ 3,380,492	\$ 5,291,502	\$ 11,262,215	\$ 12,665,652	\$ 14,642,707	\$ 17,957,154	\$ 25,953,172	\$ 29,133,629
Deferred Inflows of Resources								
Related to Fire Retiree Pensions	\$ 59,925	\$ -	\$ -	\$ -	\$ 59,925	\$ -	\$ 59,925	\$ -
Related to City Pensions	1,513,772	437,491	352,219	256,048	1,865,991	693,539	2,379,712	2,059,539
Total deferred inflows of resources	\$ 1,573,697	\$ 437,491	\$ 352,219	\$ 256,048	\$ 1,925,916	\$ 693,539	\$ 2,439,627	\$ 2,059,539
Net Position								
Net investment in capital assets	\$ 10,350,773	\$ 10,097,385	\$ 16,431,190	\$ 16,290,978	\$ 26,781,963	\$ 26,388,363	\$ 41,848,847	\$ 41,848,847
Restricted	1,131,288	1,366,477	33,234	33,234	1,131,288	1,999,711	1,131,288	1,999,711
Unrestricted	(763,154)	(1,001,176)	14,698,750	13,748,493	13,935,596	12,747,117	13,935,596	12,747,117
Total net position	\$ 10,718,907	\$ 10,462,686	\$ 31,129,940	\$ 30,072,705	\$ 41,848,847	\$ 40,535,191	\$ 56,119,738	\$ 55,597,675

**City of Two Harbors
Management's Discussion and Analysis**

FUND FINANCIAL STATEMENTS (CONTINUED)

Governmental Funds (Continued)

By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund Balance Sheet and the governmental fund Statement of Revenues, Expenditures, and Changes in Fund Balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The City maintains twelve individual governmental funds. Of these funds, two are major funds. Information is presented separately in the governmental fund Balance Sheet and in the governmental fund Statement of Revenues, Expenditures, and Changes in Fund Balances for the General Fund and the Golf Fund. Data from the other governmental funds are combined into a single, aggregated presentation. Individual fund data for each of these non-major governmental funds is provided in the form of combining statements elsewhere in this report.

The City adopts an annual appropriated budget for its General Fund and Golf funds. A budgetary comparison statement has been provided for the General Fund and Golf Fund to demonstrate compliance with this budget.

The basic governmental fund financial statements can be found on pages 22-27 of this report.

Proprietary Funds

The City maintains one type of proprietary fund. Enterprise funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The City uses enterprise funds to account for its water, sewer, electric, gas, municipal liquor, stormwater, and campground.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The proprietary funds' financial statements provide separate information for the water, sewer, electric, gas, municipal liquor, stormwater, and campground, all of which are considered major funds of the City.

The basic proprietary fund financial statements can be found on pages 28-33 of this report.

Fiduciary Funds

Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are not reflected in the government-wide financial statements because the resources of those funds are not available to support the City's own programs. The City maintains one private purpose trust fund. The accounting used for fiduciary funds is much like that used for proprietary funds.

The basic fiduciary fund financial statements can be found on page 34 of this report.

NOTES TO FINANCIAL STATEMENTS

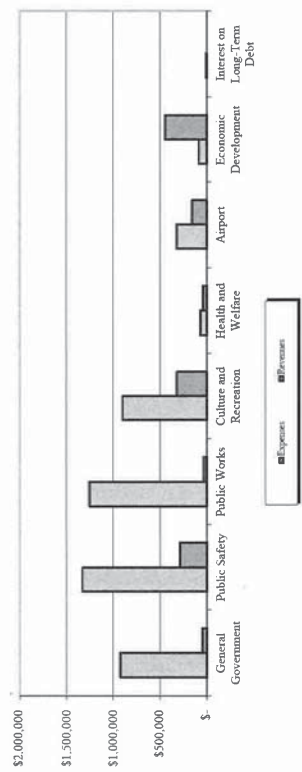
The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to financial statements can be found on pages 35-69 of this report.

City of Two Harbors
Management's Discussion and Analysis

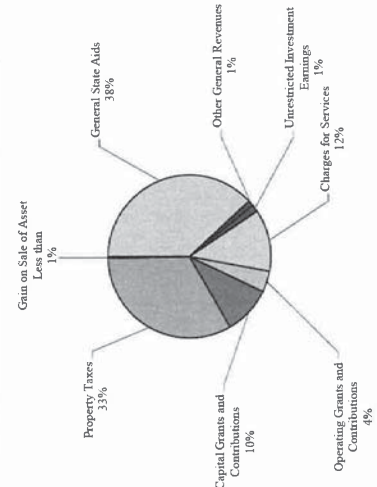
GOVERNMENT-WIDE FINANCIAL ANALYSIS (CONTINUED)

Below are specific graphs which provide comparisons of the governmental activities revenues and expenses:

Expenses and Program Revenues - Governmental Activities



Revenues by Source - Governmental Activities



City of Two Harbors
Management's Discussion and Analysis

GOVERNMENT-WIDE FINANCIAL ANALYSIS (CONTINUED)

Statement of Net Position (Continued)
The City's total net position increased by \$1,313,656 in 2017, and total assets increased \$580,946. This can be attributed to an increase in capital grants for 2017 projects and working on the design and planning phase of the City's Capital Improvement Plan. Total liabilities decreased \$3,314,447 mostly attributable to the decrease of net pension liability of \$2,307,661 in comparison to 2016.

Statement of Activities
To give users a better understanding of the sources and uses of the City's net position, the following table presents a summary of revenues, expenses, and changes in net position:

	Governmental Activities		Business-Type Activities		Total
	2017	2016	2017	2016	
Revenues					
Program revenues					
Charges for services	\$ 610,173	\$ 614,485	\$ 11,904,636	\$ 11,336,402	\$ 12,554,809
Operating grants and contributions	227,866	343,544	3,425	102,864	281,111
Capital grants and contributions	468,645	73,234		(12,722)	468,645
Governmental revenues	1,625,520	1,577,422	211	(1,146)	1,625,731
Tax revenues		91,538			91,538
General state aids	1,872,961	1,873,362	845	8,256	1,873,806
Investment income	20,535	14,322	133,041	96,519	153,576
Other general revenue	54,204	84,890			54,204
Gain on sale of asset	13,900		6,427		20,327
Total revenues	4,923,624	4,672,817	12,648,585	11,530,173	16,972,309
Expenses					
General government	924,352	1,038,655			924,352
Public safety	1,330,142	1,732,128			1,330,142
Public works	1,254,223	1,318,384			1,254,223
Culture and recreation	905,210	861,990			905,210
Health and welfare	69,065	87,635			69,065
Airport	323,257	320,601			323,257
Economic development	85,453	83,969			85,453
Interest on long-term debt	14,776	14,776			14,776
Waste disposal			1,401,169	1,346,826	1,401,169
Electric			1,355,169	1,292,243	1,355,169
Sewerage disposal			2,922,350	3,086,389	2,922,350
Gas			2,575,463	2,379,147	2,575,463
Liquor			2,196,331	2,039,411	2,196,331
Stormwater			36,152	32,277	36,152
Curbside			234,519	175,426	234,519
Compground			10,721,153	10,351,719	15,622,758
Total expenses	4,901,605	5,458,138	10,721,153	10,351,719	15,809,857
Transfers					
	234,402	(210,595)	(234,402)	210,595	
Change in net position	256,621	(995,916)	1,093,030	1,389,049	1,349,451
Net Position - Beginning	10,462,486	12,066,739	30,072,705	28,756,042	40,822,781
Net Position - Ending	\$ 10,718,907	\$ 10,462,486	\$ 31,129,940	\$ 30,072,705	\$ 41,848,847
Change in accounting principle					
Net Position - Ending					\$ 40,535,191

**City of Two Harbors
Management's Discussion and Analysis**

GOVERNMENT-WIDE FINANCIAL ANALYSIS (CONTINUED)

Governmental Activities

The governmental activities increased the City's net position by \$256,421, this can be attributed to the capital grants and contributions of \$468,645.

Business-type Activities

Business-type activities increased the City's net position by \$1,093,030. This increase is due to Administration's intent to improve operating results through increasing charges and controlling expenses.

FINANCIAL ANALYSIS OF THE GOVERNMENT'S FUNDS

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

Governmental Funds

The focus of the City's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the City's financing requirements. In particular, unrestricted fund balance may serve as a useful measure of a government's net resources available for spending at the end of the year.

As of the end of 2017, the City's governmental funds reported a combined fund balance of \$3,031,712, an increase of \$153,419 in comparison with the prior year. The nonspendable, committed, assigned, and unassigned portion of the fund balance is \$1,900,424 or 62.7%, which is available for spending at the City's discretion. \$1,131,288 is restricted to indicate it is not available for new spending because it is only available for the purposes the legal constraints placed on the use of the resources.

The General Fund is the chief operating fund of the City. At the end of the current year, the unassigned fund balance of the General Fund was \$1,971,170, and total fund balance was \$1,982,364. As a measure of the General Fund's liquidity, it may be useful to compare both unassigned fund balance and total fund balance to total fund expenditures. Unassigned fund balance represents 55.8% of total General Fund expenditures, while total fund balance represents 56.1% of that same amount. The General Fund increased \$123,028 and the key factors are discussed in the General Fund Budgetary Highlights.

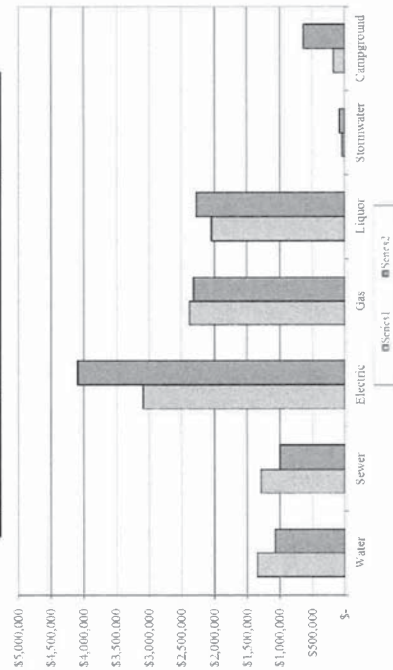
The Golf Fund is used to account for the operation of the City's Golf Course. The fund had a deficit from 2017 activity in the amount of \$164,313, with a transfer from the General Fund to cover the 2017 deficit. In 2017 the Electric Fund transferred \$100,000 to bring down the Golf Fund deficit. The Golf Fund has a fund balance deficit of \$780,217 at year end.

**City of Two Harbors
Management's Discussion and Analysis**

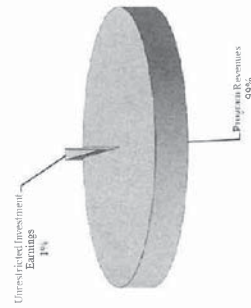
GOVERNMENT-WIDE FINANCIAL ANALYSIS (CONTINUED)

Below are specific graphs which provide comparisons of the business-type activities revenues and expenses:

Expenses and Program Revenues - Business-Type Activities



Revenues by Source - Business-Type Activities



**City of Two Harbors
Management's Discussion and Analysis**

FINANCIAL ANALYSIS OF THE GOVERNMENT'S FUNDS (CONTINUED)

Proprietary Funds

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

The proprietary funds reported combined net position of \$31,129,940. The net position increased by \$1,057,235 from last year's total of \$30,072,705. Net position consists of 52.8% investment in capital assets and 47.2% unrestricted, or available for spending at the City's discretion. Other factors concerning the finances of this fund have already been addressed in the discussion of the City's business-type activities.

GENERAL FUND BUDGETARY HIGHLIGHTS

There were no adjustments to the budget in 2017. Actual revenues were \$24,294 more than budgeted. Actual expenditures were \$153,086 less than budgeted. An increase in appropriations for the General Fund can be briefly summarized as follows:

- The General Fund received \$41,401 from the TIF fund for Administrative fees for TIF 4 & 5 during 2004 to 2017
- There was insurance proceeds of \$50,724 for the damage done to fire equipment during the Lake County Highway Department building fire

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

The City's total capital assets for its governmental and business-type activities as of December 31, 2017, was \$35,207,813 (net of accumulated depreciation). This investment in capital assets includes land, construction in progress, buildings, structures and improvements and machinery and equipment less any outstanding debt used to acquire the assets.

Major capital asset events during the current year included the following:

- The Water Treatment Facility Upgrade project was put into service during 2017; total project costs were \$5,016,174.
- Campground Complex project was put into service with final project costs at \$932,509
- Castle Danger Water Relocation project was underway for the expansion of the Castle Danger Brewery, with total project costs around \$452,000

**City of Two Harbors
Management's Discussion and Analysis**

CAPITAL ASSET AND DEBT ADMINISTRATION (CONTINUED)

	Governmental Activities		Business-Type Activities		Total	
	2017	2016	2017	2016	2017	2016
Land	\$ 310,514	\$ 310,514	\$ 95,665	\$ 95,665	\$ 406,179	\$ 406,179
Investible asset	281,528	281,528	-	-	281,528	281,528
Construction in progress	602,376	54,095	143,911	6,270,379	746,287	6,324,474
Buildings	1,505,875	1,584,353	10,821,598	5,291,658	12,327,473	6,876,011
Structures and improvements	7,393,981	7,813,539	12,875,361	12,954,658	20,269,342	20,768,197
Machinery and equipment	443,005	357,894	733,999	523,723	1,177,004	881,617
Total	\$10,537,279	\$10,401,923	\$ 24,670,534	\$25,136,083	\$ 35,207,813	\$35,538,006

Additional information on the City's capital assets can be found in Note 6.

Long-Term Debt

The City's total debt outstanding as of December 31, 2017, was \$7,903,106. This amount decreased \$643,003 during 2017 with scheduled debt service payments.

	Governmental Activities		Business-Type Activities		Total	
	2017	2016	2017	2016	2017	2016
Equipment notes payable	\$ 186,506	\$ 304,538	\$ -	\$ -	\$ 186,506	\$ 304,538
General obligation revenue notes	-	-	7,716,600	8,241,572	7,716,600	8,241,572
Total	\$ 186,506	\$ 304,538	\$ 7,716,600	\$ 8,241,572	\$ 7,903,106	\$ 8,546,110

The City also includes its obligations for compensated absences in long-term debt, which is not included in the above information. Additional information on the City's long-term debt can be found in Note 7 of this report.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

- The unemployment rate for Lake County, where the City is located, is currently 4.6 percent, which is lower than the rate of 6.1 percent a year ago. This compares unfavorably to the State's average unemployment rate of 3.9 percent and the national average of 4.4 percent.
- Inflationary trends in the region compare favorably to national indices

The City's appointed officials considered many factors when setting the fiscal year 2018 budget, rates, and fees that will be charged, including the items above. Major factors considered when adopting the 2018 budget were capital expenditures and implementing the Capital Improvement Plan for 2018 street improvements projects. Due to the changes mentioned above, the overall tax levy increased \$146,635 for calendar year 2018.

**City of Two Harbors
Management's Discussion and Analysis**

REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the City's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Finance Director, City of Two Harbors, 522 1st Avenue, Two Harbors, Minnesota 55616.

**City of Two Harbors
Statement of Net Position
December 31, 2017**

	Governmental Activities	Business-Type Activities	Total	Two Harbors Development Fund	Two Harbors Economic Development Authority
Assets					
Cash and investments (including cash equivalents)	\$ 2,776,480	\$ 16,282,111	\$ 19,058,591	\$ 146,987	\$ 27,486
Property tax receivable	47,638	71	47,709	-	-
Accounts receivable	68,330	944,500	1,012,830	220	-
Notes receivable	188,850	-	188,850	-	-
Interest receivable	3,480	60,805	64,285	-	-
Due from other governments	546,516	1,430	547,946	-	-
Internal balances	(107,842)	107,842	-	-	-
Loans receivable	-	-	-	641,709	-
Deferred special assessments receivable	18,064	17,801	35,865	-	-
Inventories	19,195	237,735	256,930	-	-
Prepaid expenses	-	4,275	4,275	-	-
Capital assets					
Land	310,514	95,666	406,180	-	-
Inexhaustible asset	281,528	-	281,528	-	-
Construction in progress	602,376	143,911	746,287	-	-
Capital assets being depreciated					
Buildings	4,067,643	19,676,631	23,744,274	-	-
Improvements	14,288,580	21,810,621	36,099,201	-	-
Structures	281,656	-	281,656	-	-
Machinery and equipment	3,905,324	3,194,771	7,100,095	-	-
Less accumulated depreciation	(13,200,342)	(20,251,066)	(33,451,408)	-	-
Net pension asset	139,068	-	139,068	-	-
Total assets	<u>14,237,058</u>	<u>42,327,104</u>	<u>56,564,162</u>	<u>788,916</u>	<u>27,486</u>
Deferred Outflows of Resources					
Deferred outflows of resources related to fire relief pensions	104,786	-	104,786	-	-
Deferred outflows of resources related to city pensions	1,331,252	417,270	1,748,522	-	-
Total deferred outflow of resources	<u>1,436,038</u>	<u>417,270</u>	<u>1,853,308</u>	<u>-</u>	<u>-</u>
Total assets and deferred outflows of resources	<u>\$ 15,673,096</u>	<u>\$ 42,744,374</u>	<u>\$ 58,417,470</u>	<u>\$ 788,916</u>	<u>\$ 27,486</u>
Liabilities					
Accounts payable	\$ 129,244	\$ 558,241	\$ 687,485	\$ -	\$ -
Contracts payable	16,188	146,987	163,175	-	-
Due to other governments	-	2,330	2,330	-	-
Accrued payroll	117,700	88,279	205,979	-	-
Accrued interest payable	2,625	42,444	45,069	-	-
Customer deposits	-	24,647	24,647	-	-
Unearned revenue	200,165	41,964	242,129	-	-
Net other post employment benefits (OPEB)	486,759	480,714	967,473	-	-
Net pension liability	1,783,797	1,622,947	3,406,744	-	-
Noncurrent liabilities					
Due within one year	285,833	717,378	1,003,211	-	-
Due in more than one year	358,181	7,536,284	7,894,465	-	-
Total liabilities	<u>3,380,492</u>	<u>11,262,215</u>	<u>14,642,707</u>	<u>-</u>	<u>-</u>
Deferred Inflows of Resources					
Deferred inflows related to fire relief pensions	59,925	-	59,925	-	-
Deferred inflows related to city pensions	1,513,772	352,219	1,865,991	-	-
Total deferred inflows of resources	<u>1,573,697</u>	<u>352,219</u>	<u>1,925,916</u>	<u>-</u>	<u>-</u>
Net Position					
Net investment in capital assets	10,350,773	16,431,190	26,781,963	-	-
Restricted for					
Revolving loans	80,340	-	80,340	-	-
Sales tax appropriations	630,580	-	630,580	-	-
Tax increment financing	273,376	-	273,376	-	-
Cemetery endowment	146,992	-	146,992	-	-
Unrestricted	<u>(763,154)</u>	<u>14,698,750</u>	<u>13,935,596</u>	<u>788,916</u>	<u>27,486</u>
Total net position	<u>10,718,907</u>	<u>31,129,940</u>	<u>41,848,847</u>	<u>788,916</u>	<u>27,486</u>
Total liabilities and net position	<u>\$ 15,673,096</u>	<u>\$ 42,744,374</u>	<u>\$ 58,417,470</u>	<u>\$ 788,916</u>	<u>\$ 27,486</u>

See notes to financial statements.

**City of Two Harbors
Statement of Activities
Year Ended December 31, 2017**

Functions/Programs	Expenses	Program Revenues	
		Charges for Services	Operating Grants and Contributions
Governmental activities			
General government	\$ 924,352	\$ 18,945	\$ 27,647
Public safety	1,330,142	169,850	119,502
Public works	1,254,223	1,629	5,500
Economic development	85,453	5,488	-
Culture and recreation	905,210	248,071	71,426
Health and welfare	69,065	43,751	-
Airport	323,257	122,439	33,611
Interest on long-term debt	9,903	-	-
Total governmental activities	<u>4,901,605</u>	<u>610,173</u>	<u>257,686</u>
Business-type activities			
Water	1,401,169	1,083,952	-
Sewage disposal	1,355,169	1,134,641	-
Electric	2,922,350	4,119,765	-
Gas	2,575,463	2,537,263	3,425
Municipal liquor	2,196,331	2,387,809	-
Stormwater	36,152	83,055	-
Campground	234,519	558,151	-
Total business-type activities	<u>10,721,153</u>	<u>11,904,636</u>	<u>3,425</u>
Total governmental and business-type activities	<u>\$ 15,622,758</u>	<u>\$ 12,514,809</u>	<u>\$ 261,111</u>
Component units			
Two Harbors Development Fund	\$ 24,151	\$ 13,513	\$ -
Two Harbors Economic Development Authority	13,094	-	10,000
Total component units	<u>\$ 37,245</u>	<u>\$ 13,513</u>	<u>\$ 10,000</u>

General revenues
Property taxes
Unrestricted state aids
Unrestricted investment earnings
Other unrestricted revenues
Gain on sale of asset
Total general revenues
Transfers
Change in net position
Net position - beginning, as previously stated
Prior period adjustment (see Note 15)
Net position - beginning, as restated
Net position - ending

See notes to financial statements.

Net (Expense) Revenues
and Changes in Net Position

Capital Grants and Contributions	Governmental Activities	Business-Type Activities	Total	Two Harbors Development Fund	Two Harbors Economic Development Authority
\$ -	\$ (877,760)	\$ -	\$ (877,760)	\$ -	\$ -
-	(1,040,790)	-	(1,040,790)	-	-
24,485	(1,222,609)	-	(1,222,609)	-	-
444,160	364,195	-	364,195	-	-
-	(585,713)	-	(585,713)	-	-
-	(25,314)	-	(25,314)	-	-
-	(167,207)	-	(167,207)	-	-
-	(9,903)	-	(9,903)	-	-
<u>468,645</u>	<u>(3,565,101)</u>	<u>-</u>	<u>(3,565,101)</u>	<u>-</u>	<u>-</u>
-	-	(317,217)	(317,217)	-	-
-	-	(220,528)	(220,528)	-	-
-	-	1,197,415	1,197,415	-	-
-	-	(34,775)	(34,775)	-	-
-	-	191,478	191,478	-	-
-	-	46,903	46,903	-	-
-	-	323,632	323,632	-	-
<u>-</u>	<u>-</u>	<u>1,186,908</u>	<u>1,186,908</u>	<u>-</u>	<u>-</u>
<u>\$ 468,645</u>	<u>\$ (3,565,101)</u>	<u>\$ 1,186,908</u>	<u>\$ (2,378,193)</u>	<u>\$ -</u>	<u>\$ -</u>
\$ -	\$ -	\$ -	\$ -	\$ (10,638)	\$ -
-	-	-	-	-	(3,094)
<u>\$ -</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(10,638)</u>	<u>(3,094)</u>
	1,625,520	211	1,625,731	-	-
	1,872,961	845	1,873,806	-	-
	20,535	133,041	153,576	88	-
	54,204	-	54,204	500	-
	13,900	6,427	20,327	-	-
	<u>3,587,120</u>	<u>140,524</u>	<u>3,727,644</u>	<u>588</u>	<u>-</u>
	<u>234,402</u>	<u>(234,402)</u>	<u>-</u>	<u>-</u>	<u>-</u>
	256,421	1,093,030	1,349,451	(10,050)	(3,094)
	10,462,486	30,072,705	40,535,191	798,966	30,580
	-	(35,795)	(35,795)	-	-
	<u>10,462,486</u>	<u>30,036,910</u>	<u>40,499,396</u>	<u>798,966</u>	<u>30,580</u>
	<u>\$ 10,718,907</u>	<u>\$ 31,129,940</u>	<u>\$ 41,848,847</u>	<u>\$ 788,916</u>	<u>\$ 27,486</u>

City of Two Harbors
Balance Sheet - Governmental Funds
December 31, 2017

	General Fund (101)	Golf (241)	Other Governmental Funds	Total Governmental Funds
Assets				
Cash and investments	\$ 1,115,551	\$ -	\$ 1,660,929	\$ 2,776,480
Taxes receivable - delinquent	47,638	-	-	47,638
Deferred special assessment receivable	18,064	-	-	18,064
Accounts receivable	22,764	280	45,286	68,330
Interest receivable	926	-	2,554	3,480
Due from other funds	902,158	-	-	902,158
Due from other governments	106,109	-	440,407	546,516
Notes receivable	-	-	188,850	188,850
Inventories	-	-	19,195	19,195
Total assets	\$ 2,213,210	\$ 280	\$ 2,357,221	\$ 4,570,711
Liabilities				
Accounts payable	\$ 43,911	\$ 469	\$ 84,864	\$ 129,244
Contracts payable	-	-	16,188	16,188
Due to other funds	-	703,009	229,972	932,981
Due to other governments	-	-	-	-
Accrued payroll	110,983	-	6,717	117,700
Unearned revenue	10,250	-	189,915	200,165
Advances from other funds	-	77,019	-	77,019
Total liabilities	165,144	780,497	527,656	1,473,297
Deferred Inflows of Resources				
Unavailable revenue - property taxes	47,638	-	-	47,638
Unavailable revenue - special assessments	18,064	-	-	18,064
Total deferred inflows of resources	65,702	-	-	65,702
Fund Balances (Deficits)				
Nonspendable	-	-	19,195	19,195
Restricted	-	-	1,131,288	1,131,288
Committed	-	-	112,054	112,054
Assigned	11,194	-	626,931	638,125
Unassigned	1,971,170	(780,217)	(59,903)	1,131,050
Total fund balances (deficits)	1,982,364	(780,217)	1,829,565	3,031,712
Total liabilities, deferred inflows of resources, and fund balances (deficits)	\$ 2,213,210	\$ 280	\$ 2,357,221	\$ 4,570,711

See notes to financial statements.

**City of Two Harbors
Reconciliation of the Balance Sheet to
the Statement of Net Position - Governmental Funds
December 31, 2017**

Total fund balances - governmental funds \$ 3,031,712

Amounts reported for governmental activities in the Statement of Net Position are different because:

Capital assets used in governmental activities are not current financial resources and, therefore, are not reported as assets in governmental funds.

Cost of capital assets	23,737,621
Less accumulated depreciation	(13,200,342)

Long-term liabilities, including bonds payable, are not due and payable in the current period and, therefore, are not reported as liabilities in the funds.

Long-term liabilities at year-end consist of

Equipment note payable	(186,506)
Compensated absences payable	(457,508)
OPEB payable	(486,759)

Delinquent property taxes, deferred special assessments, and loans receivable will be collected in future years, but are not available soon enough to pay for the current period's expenditures and, therefore, are deferred in the funds.

Delinquent property taxes	47,638
Deferred special assessments	18,064

Deferred outflows of resources and deferred inflows of resources are created as a result of various differences related to pensions that are not recognized in the governmental funds.

Deferred inflows of resources related to pensions	(1,573,697)
Deferred outflows of resources related to pensions	1,436,038

Net pension liability	(1,783,797)
-----------------------	-------------

Fire relief association net pension asset created through contributions to a defined benefit pension plan which is not recognized in the governmental funds.

139,068

Governmental funds do not report a liability for accrued interest until due and payable.

(2,625)

Total net position - governmental activities	<u>\$ 10,718,907</u>
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See notes to financial statements.

City of Two Harbors
Statement of Revenues, Expenditures, and
Changes in Fund Balances - Governmental Funds
Year Ended December 31, 2017

	General Fund (101)	Golf (241)	Other Governmental Funds	Total Governmental Funds
Revenues				
Taxes	\$ 1,358,036	\$ -	\$ 278,873	\$ 1,636,909
Licenses and permits	38,548	-	-	38,548
Intergovernmental	2,033,620	-	555,241	2,588,861
Charges for services	217,077	182,310	179,504	578,891
Fines and forfeitures	17,591	-	-	17,591
Investment income	6,656	-	13,879	20,535
Contributions and donations	-	-	17,637	17,637
Special assessments	11,319	-	-	11,319
Loan payments	-	-	5,805	5,805
Other	13,006	-	2,526	15,532
Total revenues	<u>3,695,853</u>	<u>182,310</u>	<u>1,053,465</u>	<u>4,931,628</u>
Expenditures				
Current				
General government	553,873	-	-	553,873
Public safety	1,213,432	-	-	1,213,432
Public works	1,089,538	-	-	1,089,538
Culture and recreation	186,541	309,659	266,874	763,074
Health and welfare	91,135	-	-	91,135
Economic development	-	-	85,453	85,453
Airport	-	-	144,157	144,157
Miscellaneous	217,248	-	-	217,248
Debt service				
Principal	118,032	-	-	118,032
Interest and other charges	11,565	-	-	11,565
Capital outlay				
General government	-	-	151,996	151,996
Public safety	52,487	-	-	52,487
Public works	-	-	548,281	548,281
Culture and recreation	-	36,964	-	36,964
Total expenditures	<u>3,533,851</u>	<u>346,623</u>	<u>1,196,761</u>	<u>5,077,235</u>
Excess of revenues over (under) expenditures	162,002	(164,313)	(143,296)	(145,607)
Other Financing Sources (Uses)				
Proceeds from sale of capital asset	12,451	-	1,449	13,900
Insurance Proceeds	50,724	-	-	50,724
Transfers in	376,470	264,313	514,306	1,155,089
Transfers out	(478,619)	-	(442,068)	(920,687)
Total other financing sources (uses)	<u>(38,974)</u>	<u>264,313</u>	<u>73,687</u>	<u>299,026</u>
Net change in fund balances	123,028	100,000	(69,609)	153,419
Fund Balances				
Beginning of year	<u>1,859,336</u>	<u>(880,217)</u>	<u>1,899,174</u>	<u>2,878,293</u>
End of year	<u>\$ 1,982,364</u>	<u>\$ (780,217)</u>	<u>\$ 1,829,565</u>	<u>\$ 3,031,712</u>

See notes to financial statements.

City of Two Harbors
Reconciliation of the Statement of Revenues,
Expenditures, and Changes in Fund Balances to
the Statement of Activities - Governmental Funds
Year Ended December 31, 2017

Net change in fund balances - governmental funds \$ 153,419

Amounts reported for Governmental Activities in the Statement of Activities are different because:

Capital outlays are reported in governmental funds as expenditures. However, in the Statement of Activities, the cost of those assets is allocated over the estimated useful lives as depreciation expense.

Capital outlay	735,999
Depreciation expense	(600,560)
Loss on disposal	(83)

Compensated absences are recognized as paid in the governmental funds but recognized as the expense is incurred in the Statement of Activities.

3,794

OPEB are not reported as expenditures in the governmental funds because they do not require the use of current financial resources; instead, they are expensed in the Statement of Activities.

(4,424)

Governmental funds recognized pension contributions as expenditures at the time of payment whereas the Statement of Activities factors in items related to pensions on a full accrual perspective.

Pension expense	(129,514)
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Principal payments on long-term debt are recognized as expenditures in the governmental funds but have no effect on net position in the Statement of Activities.

118,032

Interest on long-term debt in the Statement of Activities differs from the amount reported in the governmental funds because interest is recognized as an expenditure in the funds when it is due and thus requires use of current financial resources. In the Statement of Activities, however, interest expense is recognized as the interest accrues, regardless of when it is due.

1,662

Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds.

Special assessments deferred	(10,515)
Delinquent property taxes	(11,389)

Change in net position - governmental activities

\$ 256,421

See notes to financial statements.

City of Two Harbors
Statement of Revenues, Expenditures, and
Changes in Fund Balance -
Budget and Actual - General Fund
Year Ended December 31, 2017

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Over (Under)
	Original	Final		
Revenues				
General property taxes	\$ 1,693,078	\$ 1,693,078	\$ 1,328,692	\$ (364,386)
Cable television franchise tax	31,378	31,378	29,344	(2,034)
Special assessments	17,617	17,617	11,319	(6,298)
Licenses and permits	40,093	40,093	38,548	(1,545)
Intergovernmental	1,664,439	1,664,439	2,033,620	369,181
Charges for services	194,473	194,473	217,077	22,604
Fines and forfeitures	13,900	13,900	17,591	3,691
Miscellaneous revenues				
Investment income	3,200	3,200	6,656	3,456
Other	13,381	13,381	13,006	(375)
Total revenues	<u>3,671,559</u>	<u>3,671,559</u>	<u>3,695,853</u>	<u>24,294</u>
Expenditures				
Current				
General government	674,560	674,560	553,873	(120,687)
Public safety	1,221,349	1,221,349	1,213,432	(7,917)
Public works	1,139,015	1,139,015	1,089,538	(49,477)
Culture and recreation	196,487	196,487	186,541	(9,946)
Health and welfare	101,674	101,674	91,135	(10,539)
Miscellaneous	219,255	219,255	217,248	(2,007)
Debt service				
Principal	118,032	118,032	118,032	-
Interest and other charges	11,565	11,565	11,565	-
Capital outlay				
Public safety	-	-	52,487	52,487
Culture and recreation	5,000	5,000	-	(5,000)
Total expenditures	<u>3,686,937</u>	<u>3,686,937</u>	<u>3,533,851</u>	<u>(153,086)</u>
Excess of revenues over (under) expenditures	(15,378)	(15,378)	162,002	177,380
Other Financing Sources (Uses)				
Proceeds from sale of capital asset	-	-	12,451	12,451
Insurance Proceeds	-	-	50,724	50,724
Transfers in	342,019	342,019	376,470	34,451
Transfers out	(454,734)	(454,734)	(478,619)	(23,885)
Total other financing sources (uses)	<u>(112,715)</u>	<u>(112,715)</u>	<u>(38,974)</u>	<u>73,741</u>
Net change in fund balances	<u>\$ (128,093)</u>	<u>\$ (128,093)</u>	123,028	<u>\$ 251,121</u>
Fund Balance				
Beginning of year			<u>1,859,336</u>	
End of year			<u>\$ 1,982,364</u>	

See notes to financial statements.

City of Two Harbors
Statement of Revenues, Expenditures, and
Changes in Fund Balance -
Budget and Actual - Golf Special Revenue Fund
Year Ended December 31, 2017

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget - Over (Under)</u>
	<u>Original</u>	<u>Final</u>		
Revenues				
Charges for services	\$ 216,726	\$ 216,726	\$ 182,310	\$ (34,416)
Expenditures				
Parks and recreation				
Current	315,334	315,334	309,659	(5,675)
Capital outlay	<u>41,200</u>	<u>41,200</u>	<u>36,964</u>	<u>(4,236)</u>
Total parks and recreation	356,534	356,534	346,623	(9,911)
Excess of revenues under expenditures	(139,808)	(139,808)	(164,313)	(24,505)
Other Financing Sources				
Transfers in	<u>239,808</u>	<u>239,808</u>	<u>264,313</u>	<u>24,505</u>
Net change in fund balances	<u>\$ 100,000</u>	<u>\$ 100,000</u>	100,000	<u>\$ -</u>
Fund Balance				
Beginning of year			<u>(880,217)</u>	
End of year			<u>\$ (780,217)</u>	

See notes to financial statements.

City of Two Harbors
Statement of Net Position - Proprietary Funds
December 31, 2017

	<u>Water (601)</u>	<u>Sewer (602)</u>	<u>Electric (604)</u>
Assets			
Current assets			
Cash and cash equivalents	\$ 582,716	\$ 202,512	\$ -
Investments	600,000	4,250,000	6,700,000
Taxes receivable - delinquent	61	10	-
Special assessment receivable deferred	3,084	3,444	7,708
Accounts receivable	114,806	129,227	327,323
Interest receivable	4,029	16,268	31,218
Due from other funds	-	-	105,064
Due from other governments	543	186	537
Inventories	-	-	83,092
Prepaid expenses	-	-	-
Total current assets	<u>1,305,239</u>	<u>4,601,647</u>	<u>7,254,942</u>
Noncurrent assets			
Advances to other funds	-	-	599,763
Capital assets			
Capital assets	19,002,891	14,876,824	5,432,019
Construction in progress	-	140,604	3,307
Total capital assets	<u>19,002,891</u>	<u>15,017,428</u>	<u>5,435,326</u>
Less accumulated depreciation	<u>(5,577,766)</u>	<u>(8,299,587)</u>	<u>(3,129,822)</u>
Capital assets, net of Accumulated depreciation	<u>13,425,125</u>	<u>6,717,841</u>	<u>2,305,504</u>
Total noncurrent assets	<u>13,425,125</u>	<u>6,717,841</u>	<u>2,905,267</u>
Total assets	<u>14,730,364</u>	<u>11,319,488</u>	<u>10,160,209</u>
Deferred Outflows of Resources			
Deferred outflows of resources related to pension activity	<u>107,902</u>	<u>97,830</u>	<u>85,007</u>
Total assets and deferred outflows of resources	<u>\$ 14,838,266</u>	<u>\$ 11,417,318</u>	<u>\$ 10,245,216</u>
Liabilities			
Current liabilities			
Accounts payable	\$ 9,186	\$ 5,621	\$ 224,893
Contracts payable	-	-	141,987
Accrued payroll	22,789	22,300	15,409
Accrued interest payable	42,120	324	-
Unearned revenue	-	-	-
Due to other funds	-	-	505,500
Customer deposits	-	-	12,306
Due to other governments	-	-	-
Current portion of long-term debt	<u>582,704</u>	<u>44,407</u>	<u>34,906</u>
Total current liabilities	<u>656,799</u>	<u>72,652</u>	<u>935,001</u>
Long-term liabilities			
Compensated absences	168,505	138,476	90,613
Notes payable	7,627,000	89,600	-
Advances from other funds	-	-	-
Net other post employment benefits	188,223	127,314	60,402
Net pension liability	419,679	380,506	330,629
Less current portion of long-term debt	<u>(582,704)</u>	<u>(44,407)</u>	<u>(34,906)</u>
Total long-term liabilities	<u>7,820,703</u>	<u>691,489</u>	<u>446,738</u>
Total liabilities	<u>8,477,502</u>	<u>764,141</u>	<u>1,381,739</u>
Deferred Inflows of Resources			
Deferred inflows of resources related to pension activity	<u>91,080</u>	<u>82,579</u>	<u>71,754</u>
Net Position			
Net investment in capital assets	5,798,125	6,628,241	2,305,504
Unrestricted	<u>471,559</u>	<u>3,942,357</u>	<u>6,486,219</u>
Total net position	<u>6,269,684</u>	<u>10,570,598</u>	<u>8,791,723</u>
Total liabilities, deferred inflows of resources, and net position	<u>\$ 14,838,266</u>	<u>\$ 11,417,318</u>	<u>\$ 10,245,216</u>

See notes to financial statements.

<u>Gas (605)</u>	<u>Municipal Liquor (609)</u>	<u>Stormwater (651)</u>	<u>Campground (660)</u>	<u>Total</u>
\$ 275,776	\$ 357,582	\$ 113,525	\$ -	\$ 1,532,111
1,900,000	625,000	250,000	425,000	14,750,000
-	-	-	-	71
3,143	-	422	-	17,801
361,866	354	8,268	2,656	944,500
5,449	2,736	500	605	60,805
613,332	-	-	-	718,396
154	-	10	-	1,430
14,038	140,605	-	-	237,735
-	4,275	-	-	4,275
<u>3,173,758</u>	<u>1,130,552</u>	<u>372,725</u>	<u>428,261</u>	<u>18,267,124</u>
-	-	-	-	599,763
2,729,520	346,073	575,331	1,815,031	44,777,689
-	-	-	-	143,911
<u>2,729,520</u>	<u>346,073</u>	<u>575,331</u>	<u>1,815,031</u>	<u>44,921,600</u>
<u>(2,235,406)</u>	<u>(146,852)</u>	<u>(189,026)</u>	<u>(672,607)</u>	<u>(20,251,066)</u>
<u>494,114</u>	<u>199,221</u>	<u>386,305</u>	<u>1,142,424</u>	<u>24,670,534</u>
<u>494,114</u>	<u>199,221</u>	<u>386,305</u>	<u>1,142,424</u>	<u>25,270,297</u>
<u>3,667,872</u>	<u>1,329,773</u>	<u>759,030</u>	<u>1,570,685</u>	<u>43,537,421</u>
75,842	50,213	476	-	417,270
<u>\$ 3,743,714</u>	<u>\$ 1,379,986</u>	<u>\$ 759,506</u>	<u>\$ 1,570,685</u>	<u>\$ 43,954,691</u>
\$ 284,240	\$ 33,769	\$ 5	\$ 527	\$ 558,241
-	-	-	5,000	146,987
15,765	12,016	-	-	88,279
-	-	-	-	42,444
-	-	37	41,927	41,964
-	-	-	182,073	687,573
12,341	-	-	-	24,647
-	2,002	-	328	2,330
<u>33,755</u>	<u>20,387</u>	<u>-</u>	<u>1,219</u>	<u>717,378</u>
<u>346,101</u>	<u>68,174</u>	<u>42</u>	<u>231,074</u>	<u>2,309,843</u>
91,573	43,885	-	4,010	537,062
-	-	-	-	7,716,600
-	-	-	522,744	522,744
86,015	18,760	-	-	480,714
294,984	195,299	1,850	-	1,622,947
<u>(33,755)</u>	<u>(20,387)</u>	<u>-</u>	<u>(1,219)</u>	<u>(717,378)</u>
<u>438,817</u>	<u>237,557</u>	<u>1,850</u>	<u>525,535</u>	<u>10,162,689</u>
<u>784,918</u>	<u>305,731</u>	<u>1,892</u>	<u>756,609</u>	<u>12,472,532</u>
64,019	42,385	402	-	352,219
494,114	199,221	386,305	619,680	16,431,190
2,400,663	832,649	370,907	194,396	14,698,750
<u>2,894,777</u>	<u>1,031,870</u>	<u>757,212</u>	<u>814,076</u>	<u>31,129,940</u>
<u>\$ 3,743,714</u>	<u>\$ 1,379,986</u>	<u>\$ 759,506</u>	<u>\$ 1,570,685</u>	<u>\$ 43,954,691</u>

City of Two Harbors
Statement of Revenues, Expenses, and Changes
in Fund Net Position - Proprietary Funds
Year Ended December 31, 2017

	Water (601)	Sewer (602)	Electric (604)
Sales and cost of sales			
Sales	\$ -	\$ -	\$ 3,978,463
Cost of sales	-	-	2,026,756
Gross profit	<u>-</u>	<u>-</u>	<u>1,951,707</u>
Operating revenues			
Charges for services	1,067,104	1,101,542	-
Penalties	9,633	9,783	32,462
Other services	7,215	23,316	13,630
Total operating revenues	<u>1,083,952</u>	<u>1,134,641</u>	<u>46,092</u>
Operating expenses			
Wages, salaries, and compensation	435,420	440,582	380,691
Employee benefits	227,505	194,570	157,829
Materials and supplies	109,876	113,031	72,860
Professional services	9,345	61,838	42,483
Insurance	6,750	15,562	6,607
Utilities	84,940	116,762	16,269
Depreciation	384,863	375,596	121,965
Travel and training	3,310	2,844	9,874
Miscellaneous	4,921	23,570	75,390
Dues and subscriptions	12,356	8,888	8,627
Rentals - leases	243	985	2,922
Total operating expenses	<u>1,279,529</u>	<u>1,354,228</u>	<u>895,517</u>
Operating income (loss)	(195,577)	(219,587)	1,102,282
Nonoperating revenues (expenses)			
Investment income	8,850	37,764	57,427
Taxes	10	201	-
State grants and aid	361	185	120
Interest expense	(121,640)	(941)	(77)
Miscellaneous revenue	-	-	95,210
Total nonoperating revenues (expenses)	<u>(112,419)</u>	<u>37,209</u>	<u>152,680</u>
Income (loss) before transfers	(307,996)	(182,378)	1,254,962
Gain (loss) on disposal of capital assets	-	(653)	7,080
Transfers in	400,000	-	-
Transfers out	-	(2,894)	(336,362)
Change in net position	92,004	(185,925)	925,680
Net position, as previously stated			
Beginning of year	6,177,680	10,756,523	7,866,043
Prior period adjustment (Note 15)	<u>-</u>	<u>-</u>	<u>-</u>
Beginning of year, restated	<u>6,177,680</u>	<u>10,756,523</u>	<u>7,866,043</u>
End of year	<u>\$ 6,269,684</u>	<u>\$ 10,570,598</u>	<u>\$ 8,791,723</u>

See notes to financial statements.

Gas (605)	Municipal Liquor (609)	Stormwater (651)	Campground (660)	Total
\$ 2,516,691	\$ 2,391,234	\$ -	\$ -	\$ 8,886,388
1,880,238	1,739,912	-	-	5,646,906
<u>636,453</u>	<u>651,322</u>	<u>-</u>	<u>-</u>	<u>3,239,482</u>
-	-	82,444	557,542	2,808,632
14,624	-	585	-	67,087
1,981	-	-	-	46,142
<u>16,605</u>	<u>-</u>	<u>83,029</u>	<u>557,542</u>	<u>2,921,861</u>
321,444	252,424	1,777	25,413	1,857,751
141,052	85,325	-	1,256	807,537
80,952	16,412	6,066	50,226	449,423
16,256	19,694	863	63,699	214,178
2,951	3,496	389	4,219	39,974
22,137	13,637	890	32,950	287,585
70,156	7,514	25,628	37,406	1,023,128
6,719	886	-	-	23,633
17,378	54,046	471	18,285	194,061
15,427	2,985	-	1,065	49,348
665	-	68	-	4,883
<u>695,137</u>	<u>456,419</u>	<u>36,152</u>	<u>234,519</u>	<u>4,951,501</u>
(42,079)	194,903	46,877	323,023	1,209,842
22,949	4,320	1,731	609	133,650
-	-	-	-	211
107	71	1	-	845
(88)	-	-	-	(122,746)
-	-	26	-	95,236
<u>22,968</u>	<u>4,391</u>	<u>1,758</u>	<u>609</u>	<u>107,196</u>
(19,111)	199,294	48,635	323,632	1,317,038
3,967	-	-	-	10,394
-	-	-	-	400,000
<u>(93,868)</u>	<u>(1,278)</u>	<u>-</u>	<u>(200,000)</u>	<u>(634,402)</u>
(109,012)	198,016	48,635	123,632	1,093,030
3,003,789	833,854	708,577	726,239	30,072,705
-	-	-	(35,795)	(35,795)
<u>3,003,789</u>	<u>833,854</u>	<u>708,577</u>	<u>690,444</u>	<u>30,036,910</u>
<u>\$ 2,894,777</u>	<u>\$ 1,031,870</u>	<u>\$ 757,212</u>	<u>\$ 814,076</u>	<u>\$ 31,129,940</u>

City of Two Harbors
Statement of Cash Flows - Proprietary Funds
Year Ended December 31, 2017

	<u>Water (601)</u>	<u>Sewer (602)</u>	<u>Electric (604)</u>
Cash Flows - Operating Activities			
Receipts from customers and users	\$ 1,525,220	\$ 1,096,433	\$ 3,951,402
Payments to suppliers	(229,383)	(372,604)	(2,289,899)
Payments to employees	(666,782)	(592,637)	(505,485)
Net cash flows - operating activities	<u>629,055</u>	<u>131,192</u>	<u>1,156,018</u>
Cash Flows - Noncapital Financing Activities			
Transfer to other funds	-	(2,894)	(336,362)
Transfer from other funds	400,000	-	-
Interfund balances	-	273,542	337,022
State grants and aid	361	185	120
Miscellaneous revenue	-	-	95,210
Net cash flows - noncapital financing activities	<u>400,361</u>	<u>270,833</u>	<u>95,990</u>
Cash Flows - Capital and Related Financing Activities			
Principal paid on debt	(518,000)	(6,972)	-
Interest paid on debt	(123,535)	(966)	(77)
Taxes	60	191	-
Proceeds from disposal of capital assets	-	-	-
Acquisition of capital assets	(581,995)	(221,627)	(74,636)
Net cash flows - capital and related financing activities	<u>(1,223,470)</u>	<u>(229,374)</u>	<u>(74,713)</u>
Cash Flows - Investing Activities			
Net maturity (purchase) of investments	550,000	(300,000)	(1,225,000)
Interest and dividends received	10,549	34,527	47,705
Net cash flows - investing activities	<u>560,549</u>	<u>(265,473)</u>	<u>(1,177,295)</u>
Net change in cash and cash equivalents	366,495	(92,822)	-
Cash and Cash Equivalents			
January 1	<u>216,221</u>	<u>295,334</u>	<u>-</u>
December 31	<u>\$ 582,716</u>	<u>\$ 202,512</u>	<u>\$ -</u>
Reconciliation of Operating Income (Loss) to Net Cash Flows - Operating Activities			
Operating income (loss)	\$ (195,577)	\$ (219,587)	\$ 1,102,282
Adjustments to reconcile operating income (loss) to net cash flows - operating activities			
Depreciation expense	384,863	375,596	121,965
Pension related activity	(12,291)	18,645	20,812
Unearned revenue	-	-	-
Accounts receivable	(19,104)	(38,821)	(79,216)
Special assessments receivable	1,484	716	4,141
Due from other governments	458,888	(103)	(537)
Inventory	-	-	(23,712)
Accounts payable	2,358	(29,124)	(4,399)
Customer deposits	-	-	2,459
Due to other governmental units	-	-	-
Salaries payable	397	4,304	(618)
Net opeb obligation	1,711	1,157	549
Compensated absences payable	6,326	18,409	12,292
Total adjustments	<u>824,632</u>	<u>350,779</u>	<u>53,736</u>
Net cash flows - operating activities	<u>\$ 629,055</u>	<u>\$ 131,192</u>	<u>\$ 1,156,018</u>

See notes to financial statements.

<u>Gas (605)</u>	<u>Municipal Liquor (609)</u>	<u>Stormwater (651)</u>	<u>Campground (660)</u>	<u>Total</u>
\$ 2,542,613	\$ 2,390,880	\$ 84,044	\$ 561,018	\$ 12,151,610
(2,072,334)	(1,837,374)	(8,826)	(169,925)	(6,980,345)
<u>(439,449)</u>	<u>(300,976)</u>	<u>-</u>	<u>(22,659)</u>	<u>(2,527,988)</u>
<u>30,830</u>	<u>252,530</u>	<u>75,218</u>	<u>368,434</u>	<u>2,643,277</u>
(93,868)	(1,278)	-	(200,000)	(634,402)
-	-	-	-	400,000
(613,332)	-	-	33,590	30,822
107	71	-	-	844
<u>-</u>	<u>-</u>	<u>26</u>	<u>-</u>	<u>95,236</u>
<u>(707,093)</u>	<u>(1,207)</u>	<u>26</u>	<u>(166,410)</u>	<u>(107,500)</u>
-	-	-	-	(524,972)
(88)	-	-	-	(124,666)
-	-	-	-	251
3,967	-	-	-	3,967
<u>(26,327)</u>	<u>-</u>	<u>-</u>	<u>(84,404)</u>	<u>(988,989)</u>
<u>(22,448)</u>	<u>-</u>	<u>-</u>	<u>(84,404)</u>	<u>(1,634,409)</u>
850,000	(350,000)	(50,000)	(425,000)	(950,000)
29,552	2,426	1,901	4	126,664
<u>879,552</u>	<u>(347,574)</u>	<u>(48,099)</u>	<u>(424,996)</u>	<u>(823,336)</u>
180,841	(96,251)	27,145	(307,376)	78,032
94,935	453,833	86,380	307,376	1,454,079
<u>\$ 275,776</u>	<u>\$ 357,582</u>	<u>\$ 113,525</u>	<u>\$ -</u>	<u>\$ 1,532,111</u>
\$ (42,079)	\$ 194,903	\$ 46,877	\$ 323,023	\$ 1,209,842
70,156	7,514	25,628	37,406	1,023,128
12,023	31,312	1,777	-	72,278
-	-	-	6,132	6,132
6,520	(354)	1,124	(2,656)	(132,507)
1,512	-	(99)	-	7,754
(154)	-	(10)	-	458,084
336	7,657	-	-	(15,719)
(29,947)	4,035	(79)	191	(56,965)
1,439	-	-	-	3,898
-	2,002	-	328	2,330
406	770	-	-	5,259
782	170	-	-	4,369
9,836	4,521	-	4,010	55,394
<u>72,909</u>	<u>57,627</u>	<u>28,341</u>	<u>45,411</u>	<u>1,433,435</u>
<u>\$ 30,830</u>	<u>\$ 252,530</u>	<u>\$ 75,218</u>	<u>\$ 368,434</u>	<u>\$ 2,643,277</u>

**City of Two Harbors
Statement of Fiduciary Net Position
December 31, 2017**

	Two Harbors Convention and Visitors Bureau	Recreation Private Purpose Trust Fund
Assets		
Cash and investments	\$ 107,672	\$ 67,072
Other receivables	7,152	-
Total assets	\$ 114,824	\$ 67,072
Liabilities		
Accounts payable	\$ 114,824	3,480
Accrued payroll	-	364
Total liabilities	\$ 114,824	\$ 3,844
Net Position		
Held in trust		\$ 63,228

**Statement of Changes in Fiduciary Net Position
Year Ended December 31, 2017**

	Recreation Private Purpose Trust Fund
Additions	
Contributions	\$ 73,172
Charges for services	18,908
Total additions	92,080
Deductions	
Program expenditures	74,171
Change in net position	17,909
Net Position	
Beginning of year	45,319
End of year	\$ 63,228

See notes to financial statements.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Organization

1. General

The Home Rule Charter of the City of Two Harbors (the "City") was adopted on February 26, 1907. The elective officers of the City consist of the Mayor and six Council Members. All elective officers are elected biennially by the eligible voters of the City. The Mayor is the Chief Executive Officer, whose powers are provided for in the Two Harbors Home Rule Charter, Chapter IV.

2. City Council

The legislative power and authority of the City is vested in the City Council. Its powers and duties are prescribed in the Two Harbors Home Rule Charter, Chapter V. The City Council elects a president and vice president biennially from its members. The President presides at City Council meetings.

3. City Administrator

The City Administrator is appointed biennially by the City Council and keeps a record of all meetings of the City Council and acts as custodian of all papers and records of the City.

4. Finance Director

The Finance Director is appointed biennially by the City Council and is the custodian of all money received by the City. The Finance Director performs the duties of the city treasurer as provided for in the Two Harbors Home Rule Charter, Chapter VII.

B. Reporting Entity

The financial statements present the City and its component units. The City includes all funds, organizations, institutions, agencies, departments, and offices that are not legally separate from such. Component units are legally separate organizations for which the elected officials of the City are financially accountable and are included within the financial statements of the City because of the significance of their operational or financial relationships with the City.

The City is considered financially accountable for a component unit if it appoints a voting majority of the organization's governing body and it is able to impose its will on the organization by significantly influencing the programs, projects, activities or level of services performed or provided by the organization or there is a potential for the organization to provide specific financial benefits to or impose specific financial burdens on, the City.

1. Discretely Presented Component Units

The Two Harbors Development Fund (the "Fund") is a legal entity separate from the City. The Fund was established in 1985 to promote the economic development within and surrounding the City by providing loans or other financial aid to businesses not able to obtain adequate or appropriate financing from other sources. These businesses are located or need to be located within either the City or an area having an economic impact upon the City. Preferences are given to businesses that provide or will provide training and employment opportunities for unemployed and underemployed individuals.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

B. Reporting Entity (Continued)

1. Discretely Presented Component Units (Continued)

The Two Harbors Economic Development Authority (THEDA) is a legal entity separate from the City. THEDA is governed by a five member board made up of members of the community.

Separate financial statements are included in this report for the Fund and THEDA to emphasize that they are legally separate from the City. Both the Fund and THEDA are presented as governmental fund types.

C. Government-Wide and Fund Financial Statements

The government-wide financial statements (i.e., the Statement of Net Position and the Statement of Activities) report information on all of the nonfiduciary activities of the City. The fiduciary funds are only reported in the statement of fiduciary net position and the statement of changes in fiduciary net position at the fund financial statement level. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support.

The Statement of Activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Interest on general long-term debt is considered an indirect expense and is reported separately in the Statement of Activities. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues. Internally dedicated revenues are reported as general revenues rather than program revenues.

Separate financial statements are provided for governmental funds and proprietary funds. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements.

The Two Harbors Convention and Visitors Bureau Agency Fund and the Private Purpose Trust Fund are presented in the fiduciary fund financial statements. Since, by definition, these assets are being held for the benefit of a third party (other local governments, private parties, etc.) and cannot be used to address activities or obligations of the City, these Funds are not incorporated into the government-wide statements.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

D. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary fund and fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the City considers revenues to be available if they are collected within 60 days of the end of the current period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment matures.

Property taxes, franchise taxes, licenses, and interest associated with the current period are all considered to be susceptible to accrual and so have been recognized as revenues of the current period. Only the portion of special assessments receivable due within the current period is considered to be susceptible to accrual as revenue of the current period. All other revenue items are considered to be measurable and available only when cash is received by the City.

Description of Funds:

Major Governmental Funds:

General Fund – This Fund is the City's primary operating fund. It accounts for all financial resources of the general City, except those required to be accounted for in another fund.

Golf Special Revenue Fund – This Fund accounts for the activities of the City's golf course.

Proprietary Funds:

Water Fund – This Fund accounts for the operations of the City's water utility.

Sanitary Sewer Fund – This Fund accounts for the operations of the City's sewer utility.

Electric Fund – This Fund accounts for the operations of the City's electric utility.

Gas Fund – This Fund accounts for the operations of the City's gas utility.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

D. Measurement Focus, Basis of Accounting, and Financial Statement Presentation (Continued)

Description of Funds: (Continued)

Proprietary Funds: (Continued)

Municipal Liquor Fund – This Fund accounts for the operations of the City's Municipal Liquor Store.

Storm Water Fund – This Fund accounts for the activities of the City's storm water utility.

Campground Fund – This Fund accounts for the operations of the City's campground.

Fiduciary Fund:

Recreation Private Purpose Trust Fund – This Fund accounts for the activities sponsored and run by the Recreation Board.

Two Harbors Convention and Visitors Bureau Agency Fund – This Fund accounts for the activities sponsored and run by the Convention and Visitors Bureau.

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are charges between the City's utility functions and various other functions of the City. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the enterprise funds are charges to customers for sales and services. Operating expenses for enterprise funds include the cost of sales and services, administrative expenses and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

When both restricted and unrestricted resources are available for use, it is the City's policy to use restricted resources first, then unrestricted resources as they are needed.

When committed, assigned, or unassigned resources are available for use, it is the City's policy to use resources in the following order: committed, assigned, and unassigned.

E. Assets, Liabilities, Deferred Outflows/Inflows of Resources, and Net Position or Equity

1. Deposits and Investments

The City's cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

E. Assets, Liabilities, Deferred Outflows/Inflows of Resources, and Net Position or Equity (Continued)

1. Deposits and Investments (Continued)
Minnesota Statutes authorizes the City to invest in obligations of the U.S. Treasury, agencies and instrumentalities, shares of investment companies whose only investments are in the aforementioned securities, obligations of the State of Minnesota or its municipalities, bankers' acceptances, future contracts, repurchase and reverse repurchase agreements, and commercial paper of the highest quality with a maturity of no longer than 270 days and in the Minnesota Municipal Investment Pool.

2. Inventory and Prepaid Items
Inventory is valued at cost using the weighted average method. Inventories of governmental funds are recorded as expenditures when consumed rather than when purchased.

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items in both government-wide and fund financial statements. Prepaid items are recorded as an expenditure at the time of consumption.

3. Taxes Receivable
Delinquent taxes receivable represent the past six years of uncollected tax levies.

4. Loans Receivable
Loans receivable represent the balance of loans made to local businesses for the purpose of economic development.

5. Trade Receivables
All proprietary fund service receivables are shown net of an allowance for doubtful accounts. Allowances for receivables are calculated as follows:

Days	Allowance Percentage
30-60	10 %
60-90	25
90-120	50
120+	100

6. Capital Assets
Capital assets, which include property, plant, equipment, and infrastructure assets (e.g., roads, sidewalks, and similar items), are reported in the applicable governmental or business-type activities columns in the government-wide financial statements. Capital assets are defined by the City as assets with an initial individual cost of more than \$10,000 and an estimated useful life in excess of two years. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at acquisition value at the date of donation.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

E. Assets, Liabilities, Deferred Outflows/Inflows of Resources, and Net Position or Equity (Continued)

6. Capital Assets (Continued)
The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

Property, plant, and equipment of the City are depreciated using the straight-line method over the following estimated useful lives:

Assets	Years
Buildings and building improvements	5-40
Other improvements	10-25
Infrastructure	20-75
Machinery and equipment	3-10

7. Deferred Outflows/Inflows of Resources

In addition to assets, the statement of financial position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element represents a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expense/expenditure) until that time. The City has one item that qualifies for reporting in this category. The City presents deferred outflows of resources on the statement of net position for deferred outflows of resources related to pensions for various estimate differences that will be amortized and recognized over future years.

In addition to liabilities, the statement of financial position and fund financial statements will sometimes report a separate section for deferred inflows of resources. This separate financial statement element represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time. The City has two items that qualify for reporting in this category. The City presents deferred inflows of resources on the Governmental Fund Balance Sheet as unavailable revenue. The governmental funds report unavailable revenues from two sources: property taxes and special assessments. These amounts are deferred and recognized as an inflow of resources in the period that the amounts become available. The City presents deferred inflows of resources on the Statement(s) of Net Position for deferred inflows of resources related to pensions for various estimate differences that will be amortized and recognized over future years.

8. Compensated Absences

Vacation leave is recognized as an expenditure or expense when taken. City employees are granted between 5 and 30 days of vacation per year depending upon the years of service and union bargaining unit. Up to 5 days of unused vacation leave can be carried over to the succeeding year.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

E. Assets, Liabilities, Deferred Outflows/Inflows of Resources, and Net Position or Equity (Continued)

11. Fund Equity (Continued)

a. Classification (Continued)

- Restricted Fund Balance – These are amounts that are restricted to specific purposes either by a) constraints placed on the use of resources by creditors, grantors, contributors, or laws or regulations of other governments or b) imposed by law through enabling legislation.
- Committed Fund Balance – These are amounts that can only be used for specific purposes pursuant to constraints imposed by the City Council (highest level of decision making authority) through resolution.
- Assigned Fund Balance – These are amounts that are constrained by the City's intent to be used for specific purposes but are neither restricted nor committed. Assignments are made by the City's Administrator based on the City Council's direction.
- Unassigned Fund Balance – These are residual amounts in the General Fund not reported in any other classification. The General Fund is the only fund that can report a positive unassigned fund balance. Other funds would report a negative unassigned fund balance should the total of nonspendable, restricted, and committed fund balances exceed the total net resources of that fund.

b. Minimum Fund Balance

The City's target General Fund balance is to maintain unrestricted fund balance of 2.5% of the subsequent year's budgeted expenditures.

12. Net Position

Net position represents the difference between assets and deferred outflows of resources; and liabilities and deferred inflows of resources in the government-wide financial statements. Net investment in capital assets consists of capital assets, net of accumulated depreciation, reduced by the outstanding balance of any long-term debt used to build or acquire the capital assets. Net position is reported as restricted in the government-wide financial statement when there are limitations on their use through external restrictions imposed by creditors, grantors, or laws or regulations of other governments.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

E. Assets, Liabilities, Deferred Outflows/Inflows of Resources, and Net Position or Equity (Continued)

8. Compensated Absences (Continued)

City employees earn sick leave at the rate of 24 days per year and may accumulate 150 days depending on the union contract. In addition, emergency sick leave may be accumulated up to an additional 60 days but cannot be used until the original 150 days of sick leave are used.

Any employee who has rendered at least 20 years of service is entitled upon retirement to a cash payment of 60% of their accumulated sick leave balance or may elect to have an amount equal to 60% of their accumulated sick leave balance applied to their health insurance after retirement.

9. Long-Term Obligations

In the government-wide financial statements and proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities or proprietary fund type Statement of Net Position.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

10. Pensions

For purposes of measuring the net pension liability, deferred outflows/inflows of resources, and pension expense, information about the fiduciary net position of the Public Employees Retirement Association (PERA) and the relief association and additions to/deductions from PERA's and the relief association's fiduciary net position have been determined on the same basis as they are reported by PERA and the relief association except that PERA's fiscal year end is June 30. For this purpose, plan contributions are recognized as of employer payroll paid dates and benefit payments and refunds are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

11. Fund Equity

a. Classification

In the fund financial statements, governmental funds report fund classifications that comprise a hierarchy based primarily on the extent to which the City is bound to honor constraints on the specific purpose for which amounts in those funds can be spent.

- Nonspendable Fund Balance – These are amounts that cannot be spent because they are not in spendable form.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

F. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenue and expenditures/expense during the reporting period. Actual results could differ from those estimates.

G. Property Tax Collection Calendar

The City levies its property tax for the subsequent year during the month of December. December 28 is the last day the City can certify a tax levy to the County Auditor for collection the following year. The property tax is recorded as revenue when it becomes measurable and available. Lake County is the collecting agency for the levy and remits the collections to the City two times a year. Taxes not collected as of December 31 each year are shown as delinquent taxes receivable.

The County Auditor prepares the tax list for all taxable property in the City, applying the applicable tax rate to the tax capacity of individual properties, to arrive at the actual tax for each property. The County Auditor submits a list of taxes to be collected on each parcel of property to the County Treasurer in January of each year.

The County Treasurer collects all taxes and is required to mail copies of all personal property tax statements and real estate tax statements by April 15 of each year.

Property owners are required to pay one-half of their real estate taxes due by May 15 and the balance by October 15. If taxes due May 15 are not paid on time, a penalty of 3% is assessed on homesteaded property and 7% on nonhomesteaded property. An additional 1% penalty is added each month the taxes remain unpaid until October 15. If the taxes due May 15 are not paid by October 15, a 2% penalty per month is added to homesteaded property and 4% per month to nonhomesteaded property until January 1.

If the taxes are not paid by January 1, further penalties are added. Penalties and interest apply to both taxes and special assessments. There are some exceptions to the above penalties, but they are not material.

Within 30 days after the tax settlement date, the County Treasurer is required to pay 70% of the estimated collections of taxes and special assessments to the Finance Director. The County Treasurer must pay the balance to the Finance Director within 60 days after settlement, provided that after 45 days interest accrues at the rate of 8% per annum.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

H. Budgetary Information

1. In September of each year, City Staff submits to the City Council, a proposed operating budget for the year commencing the following January 1. The operating budget includes proposed expenditures and the means of financing them for the upcoming year.
2. The budget is legally enacted through passage of a resolution.
3. Budgets for the General and Special Revenue Funds are adopted on a basis consistent with accounting principles generally accepted in the United States of America.
4. Expenditures may not legally exceed budgeted appropriations at the department level. No fund's budget can be increased without City Council approval. The City Council may authorize a transfer of budgeted amounts between departments within any fund. Management may amend budgets within a department level, so long as the total department budget is not changed.
5. Formal budgetary integration is employed as a management control device during the year for the General and Special Revenue Funds. Formal budgetary integration is not employed for Debt Service Funds because effective budgetary control is alternatively achieved through general obligation bond indenture provisions. Budgetary control for Capital Projects Funds is accomplished through the use of project controls.
6. The Finance Director presents monthly expenditure and revenue reports to the City Council.

Budgeted amounts are as originally adopted or as amended by the City Council. Individual amendments were not material in relation to the original amounts budgeted. Budgeted expenditure appropriations lapse at year-end.

NOTE 2 – STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

A. Deficit Fund Balance

The following Fund had a deficit fund balance at December 31, 2017:

Golf Course Special Revenue Fund	\$ (780,217)
Capital Equipment Fund	(59,903)
Total	<u>\$ (840,120)</u>

NOTE 3 – DEPOSITS

Cash balances of the City's funds are combined (pooled) and invested to the extent available in various investments authorized by *Minnesota Statutes*. Each fund's portion of this pool (or pools) is displayed on the financial statements as cash and cash equivalents or investments. For purposes of identifying risk of investing public funds, the balances and related restrictions are summarized as follows.

In accordance with applicable *Minnesota Statutes*, the City maintains deposits at depository banks authorized by the City Council.

City of Two Harbors
Notes to Financial Statements

NOTE 3 – DEPOSITS (CONTINUED)

Custodial Credit Risk – Deposits: The City has an investment policy in place to address custodial credit risk for deposits, stating all deposits and investments must be in compliance with *Minnesota Statutes* 118A, protected by federal depository insurance and corporate surety bonds or collateral equal to 110% of the deposits not covered by Federal Deposit Insurance Corporation (FDIC) insurance, National Credit Union Administration (NCUA) or corporate surety bonds. As of December 31, 2017, the City's bank balance was not exposed to custodial credit risk because it was insured and fully collateralized with securities held by the pledging financial institution's trust department or agent and in the City's name. As of December 31, 2017, the City's deposits consisted of the following:

Checking	\$ 2,608,625
Savings	144,633
Nonnegotiable certificates of deposit	<u>16,651,000</u>
Total deposits	<u>\$ 19,404,258</u>

Interest Rate Risk: The City's investment policy sets limits on investment maturities by investing operating funds primarily in short-term securities with not more than 20% of the portfolio invested beyond five years and none beyond ten years. The policy also states maturity dates should be structured to meet cash requirements for ongoing operations.

Credit Risk: The City's investment policy states investments will be limited to those allowed by *Minnesota Statutes* 118A.04 to prevent exposure to credit risk. It also requires diversification of the investment portfolio so the impact of potential losses from any one type of security issuer will be minimized.

Concentration of Credit Risk: The City's investment policy places no limit on the amount the City may invest in any one issuer; however, it does state diversification strategies shall be determined and revised periodically by the investment officer for all funds.

Custodial Credit Risk – Investments: For an investment, this is the risk that in the event of the failure of the counterparty, the City will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The City's investment policy states investments shall either be collateralized or held in third party safekeeping by an institution designated as a primary agent.

Deposits

The following is a summary of total deposits	
Perky cash	\$ 3,550
Deposits and investments	<u>19,404,258</u>
Total deposits and investments	<u>\$ 19,407,808</u>

City of Two Harbors
Notes to Financial Statements

NOTE 3 – DEPOSITS (CONTINUED)

Deposits (Continued)

Deposits and investments are presented in the December 31, 2017, basic financial statements as follows:

Statements of Net Position	
Cash and investments	
Primary government	\$ 19,058,591
Component units	
Two Harbors Development Fund	146,987
Two Harbors Economic Development Authority	27,486
Statement of Fiduciary Net Position	
Cash and investments	<u>174,744</u>
Total	<u>\$ 19,407,808</u>

NOTE 4 – INTERFUND ACTIVITY

A. Transfers

Transfers among funds were to assist with debt service obligations and to cover costs of general operations or capital acquisition.

	Transfers In				
	General	Golf	Water	Other Governmental	Total
Transfers out					
General	\$ -	\$ 164,313	\$ -	\$ 314,306	\$ 478,619
Other governmental					
funds	42,068	-	400,000	-	442,068
Sewer	2,894	-	-	-	2,894
Electric	236,362	100,000	-	-	336,362
Gas	93,868	-	-	-	93,868
Municipal liquor	1,278	-	-	-	1,278
Campground	-	-	-	200,000	200,000
Total	<u>\$ 376,470</u>	<u>\$ 264,313</u>	<u>\$ 400,000</u>	<u>\$ 514,306</u>	<u>\$ 1,555,089</u>

City of Two Harbors
Notes to Financial Statements

NOTE 4 – INTERFUND ACTIVITY (CONTINUED)

B. Interfund Receivables/Payables

The following balances arise from negative cash balances in the debtor fund or represent the current portion of advances as described below.

Fund	Due from Other Funds	Due to Other Funds
General	\$ 902,158	\$ -
Golf special revenue	-	703,009
Other Governmental	-	229,972
Electric	105,064	505,500
Gas	613,332	-
Camppground	-	182,073
Total	<u>\$ 1,620,554</u>	<u>\$ 1,620,554</u>

C. Advances

An advance from the Electric Fund to the Golf Fund was made for the defeasance of the golf course debt. This loan will be repaid over a period of ten years. At December 31, 2017, the balance of this advance was \$77,019, with the current portion included above as due to/from other funds of \$30,824.

An advance from the Electric Fund to the Camppground Fund was made for the Camppground Bath House Building Project. This loan will be repaid over a period of ten years at 1% interest. At December 31, 2017, the balance was \$522,744 with the current portion shown above as a due to/from other funds of \$182,073.

City of Two Harbors
Notes to Financial Statements

NOTE 5 – LOANS RECEIVABLE

Loans receivable at December 31, 2017, were as follows:

Development commission loan		\$ 162,683
Bodies in Balance Economic Development Loan		
\$200,000 loan, due in monthly installments of \$1,110, through December 2019, interest at 3.0%		18,679
John and Christine McCarthy Economic Development Loan		
\$31,954 loan, due in monthly installments of \$574 through October 2020, interest at 3.0%		200,000
Bullrite, LLC.		
\$200,000 loan due in full on February 1, 2018. Interest payments monthly at 3%		34,885
Neil Myrdal Economic Development Loan		
\$38,825 loan, due in monthly installments of \$350 through April 2026, interest at 3.0%		6,218
Two Harbors Aero Storefront Renovation Loan		
\$7,500 loan, due in monthly installments of \$175 through January 2024, interest at 3.0%		7,888
Jason Vincent		
\$15,000 loan, due in monthly installments of \$270 through April 2020, interest at 3.0%		188,850
City of Two Harbors: (Cruikshank Dev. Project)		
\$200,000 loan, due in monthly installments of \$1,196 October 2016, through September 2034, interest at 3.0%		13,127
Lake County Historical Society Storefront Renovation Loan		
\$15,000 loan, due in monthly installments of \$270 through April 2022, interest at 3.0%		

City of Two Harbors
Notes to Financial Statements

NOTE 5 – LOANS RECEIVABLE (CONTINUED)

James and Amy Poe Renovation Loan
\$15,000 loan, due in monthly installments of \$270
through July 2018, interest at 3.0%

John and Christine McCarthy Renovation Loan
\$15,000 loan, due in monthly installments of \$270
through July 2018, interest at 3.0%

Total loans receivable

	\$ 4,400
	\$ 4,979
	\$ 641,709

NOTE 6 – CAPITAL ASSETS

Capital asset activity for the year ended December 31, 2017, was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Governmental activities				
Capital assets not being depreciated				
Land	\$ 310,514	\$ -	\$ -	\$ 310,514
Indestructible asset	281,528	-	-	281,528
Construction in progress	54,095	548,281	-	602,376
Total capital assets not being depreciated	646,137	548,281	-	1,194,418
Capital assets being depreciated				
Buildings	4,036,588	31,055	-	4,067,643
Improvements	14,296,962	-	8,382	14,288,580
Structures	281,656	-	-	281,656
Machinery and equipment	3,748,661	156,663	-	3,905,324
Total capital assets being depreciated	22,363,867	187,718	8,382	22,543,203
Less accumulated depreciation for				
Buildings	2,452,235	109,533	-	2,561,768
Improvements	6,683,552	411,384	8,299	7,086,637
Structures	81,526	8,092	-	89,618
Machinery and equipment	3,390,768	71,551	-	3,462,319
Total accumulated depreciation	12,608,081	600,560	8,299	13,200,342
Total capital assets being depreciated, net	9,755,786	(412,842)	83	9,342,861
Governmental activities, capital assets, net	\$ 10,401,923	\$ 135,439	\$ 83	\$ 10,537,279

City of Two Harbors
Notes to Financial Statements

NOTE 6 – CAPITAL ASSETS (CONTINUED)

Depreciation expense was charged to functions/programs of the City as follows:

Governmental activities	
General government	\$ 35,344
Public safety	44,198
Public works	249,430
Culture and recreation	92,243
Health and welfare	129
Airport	179,216
	\$ 600,560

Total depreciation expense - governmental activities

	Beginning Balance	Increases	Decreases	Ending Balance
Business type activities				
Capital assets not being depreciated				
Land	\$ 95,666	\$ -	\$ -	\$ 95,666
Construction in progress	6,270,379	194,792	6,321,260	143,911
Total capital assets not being depreciated	6,366,045	194,792	6,321,260	239,577
Capital assets being depreciated				
Buildings	13,727,974	5,948,657	-	19,676,631
Structures and improvements	21,417,395	406,651	13,425	21,810,621
Machinery and equipment	2,884,002	322,313	11,544	3,194,771
Total capital assets being depreciated	38,029,371	6,677,621	24,969	44,682,023
Less accumulated depreciation for				
Buildings	8,436,318	418,716	-	8,855,034
Structures and improvements	8,462,737	487,628	15,105	8,935,260
Machinery and equipment	2,360,278	116,784	16,290	2,460,772
Total accumulated depreciation	19,259,333	1,023,128	31,395	20,251,066
Business-type activities capital assets, being depreciated, net	18,770,038	5,654,493	(6,426)	24,430,957
Business-type activities capital assets, net	\$ 25,136,083	\$ 5,849,285	\$ 6,314,834	\$ 24,670,534

City of Two Harbors
Notes to Financial Statements

NOTE 6 – CAPITAL ASSETS (CONTINUED)

Depreciation expense was charged to functions/programs of the City as follows:

Business-type activities	
Water	\$ 384,863
Sewer	375,596
Electric	121,965
Gas	70,156
Liquor	7,514
Storm water	25,628
Canpground	<u>37,406</u>
Total depreciation expense - business-type activities	<u>\$ 1,023,128</u>

NOTE 7 – LONG-TERM DEBT

A. Components of Long-Term Liabilities

Primary government Long-term liabilities	Issue Date	Interest Rates	Original Issue	Final Maturity	Principal Outstanding	Due Within One Year
Governmental activities						
G.O. equipment note, 2012	04/19/12	4.20%	\$ 783,263	03/01/19	\$ 186,506	\$ 121,041
Compensated absences					457,508	162,792
Total governmental activities					<u>\$ 644,014</u>	<u>\$ 283,833</u>
Business-Type Activities						
G.O. notes, including refunding notes						
G.O. Water Note, 1999A	06/30/99	3.04%	835,000	08/20/19	\$ 112,000	\$ 55,000
G.O. Water Note, 2008A	05/15/08	3.44%	453,470	11/18/22	195,000	35,000
PFA Water Note, 2009	12/14/09	2.53%	2,387,496	08/20/29	1,443,000	104,000
PFA Water Note, 2010	05/11/10	1.67%	2,262,255	08/20/29	1,497,000	114,000
PFA Revolving Fund (Sewer) 2015	10/13/14	1.00%	122,152	08/20/29	89,600	7,100
PFA Water Note 2015	08/06/15	1.00%	4,741,091	08/20/35	4,380,000	223,000
Compensated absences					537,062	179,278
Total business-type activities					<u>\$ 8,253,662</u>	<u>\$ 717,378</u>
Total all long-term liabilities					<u>\$ 8,897,676</u>	<u>\$ 1,001,211</u>

Long-term indebtedness listed above was issued to finance acquisition and construction of capital facilities or to refinance (refund) previous bond issues. The General Fund is responsible for the repayment of the General Obligation (G.O.) Equipment Note, The General, Library, and Golf Funds and each enterprise fund liquidate their individual compensated absence liabilities.

The Water and Sewer Funds are each responsible for the repayment of the corresponding G.O. Notes.

City of Two Harbors
Notes to Financial Statements

NOTE 7 – LONG-TERM DEBT (CONTINUED)

B. Changes in Long-Term Liabilities

Long-term liability activity for the year ended December 31, 2017, was as follows:

	Beginning Balance	Additions	Maturities	Ending Balance	Due Within One Year
Governmental activities					
Long-term liabilities					
G.O. equipment notes	\$ 304,538	\$ -	\$ 118,032	\$ 186,506	\$ 123,041
Compensated absences	461,302	98,224	102,018	457,508	162,792
Total governmental activities	765,840	98,224	220,050	644,014	285,833
Business-type activities					
Bonds payable					
G.O. revenue notes	8,241,572	-	\$24,972	7,716,600	\$38,100
Compensated absences	481,668	171,673	116,279	537,062	179,278
Total business-type activities	8,723,240	171,673	641,251	8,253,662	717,378
Total all long-term liabilities	<u>\$ 9,489,080</u>	<u>\$ 269,897</u>	<u>\$ 861,301</u>	<u>\$ 8,897,676</u>	<u>\$ 1,003,211</u>

C. Maturity Schedules

Year Ending December 31,	Governmental Activities		Business-Type Activities	
	G.O. Equipment Notes Principal	Interest	G.O. Revenue Notes Principal	Interest
2018	\$ 123,041	\$ 6,555	\$ 538,100	\$ 117,106
2019	63,465	1,332	553,100	107,036
2020	-	-	503,200	96,698
2021	-	-	509,300	87,962
2022	-	-	515,400	79,086
2023-2027	-	-	2,495,800	277,415
2028-2032	-	-	1,816,700	94,631
2033-2035	-	-	785,000	15,750
Total	<u>\$ 186,506</u>	<u>\$ 7,887</u>	<u>\$ 7,716,600</u>	<u>\$ 875,684</u>

City of Two Harbors
Notes to Financial Statements

NOTE 8 – CONDUIT DEBT

Conduit debt obligations are certain limited-obligation revenue bonds or similar debt instruments issued for the express purpose of providing capital financing for a specific third party. The City has issued revenue bonds to provide funding to private-sector entities for projects deemed to be in the public interest. Although these bonds bear the name of the City, the City has no obligation for such debt beyond the resources provided by related leases or loans. Accordingly, the bonds are not reported as liabilities in the financial statements of the City.

As of December 31, 2017, the following issues were outstanding:

Name	Date of Issue	Original Amount of Issue	Outstanding as of 12/31/17
Lake View Memorial Hospital	2003	\$ 6,000,000	\$ 3,400,345
Health care facilities revenue bonds			

NOTE 9 – FUND BALANCE DETAIL

Fund equity balances are classified as follows to reflect the limitations and restrictions of the respective funds:

	Other Governmental Funds			Total
	General	Golf		
Nonspendable	\$ -	\$ -	\$ 19,195	\$ 19,195
Inventory				
Restricted				
Revolving loans			80,340	80,340
Sales tax appropriations			630,580	630,580
Tax increment financing			273,376	273,376
Cemetery endowment			146,992	146,992
Total restricted			1,131,288	1,131,288
Committed				
Airport			14,343	14,343
Library			97,711	97,711
Total committed			112,054	112,054
Assigned				
Drug and alcohol forfeiture	10,631	-	-	10,631
Police donations	563	-	-	563
Library	-	9,742	-	9,742
Capital projects	-	452,320	-	452,320
Street Improvement Fund	-	164,869	-	164,869
Total assigned	11,194	-	626,931	638,125
Unassigned	1,971,170	(780,217)	(59,903)	1,131,050
Total	\$ 1,982,364	\$ (780,217)	\$ 1,829,565	\$ 3,031,712

City of Two Harbors
Notes to Financial Statements

NOTE 10 – RISK MANAGEMENT

The City purchases commercial insurance coverage through the League of Minnesota Cities Insurance Trust (LMCIT) with other cities in the state which is a public entity risk pool currently operating as a common risk management and insurance program. The City pays an annual premium to the LMCIT for its insurance coverage. The LMCIT is self-sustaining through commercial companies for excess claims. The City is covered through the pool for any claims incurred but unreported, however, retains risk for the deductible portion of its insurance policies. The amount of these deductibles is considered immaterial to the financial statements.

There were no significant reductions in insurance from the previous year or settlements in excess of insurance coverage for any of the past three years.

The City's workers' compensation insurance policy is retrospectively rated. With this type of policy, final premiums are determined after loss experience is known. The amount of premium adjustment for 2017 was estimated to be immaterial based on workers' compensation rates and salaries for the year.

At December 31, 2017, there were no other claims liabilities reported in the fund based on the requirements of GASB Statement No. 10, which requires a liability for claims be reported if information prior to the issuance of the financial statements indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated.

NOTE 11 – PENSION PLANS

The city participates in various pension plans, total pension expense for the year ended December 31, 2017 was \$510,359. The components of pension expense are noted in the following plan summaries.

Public Employees' Retirement Association

A. Plan Description

The City participates in the following cost-sharing multiple-employer defined benefit pension plans administered by PERA. PERA's defined benefit pension plans are established and administered in accordance with *Minnesota Statutes*, Chapters 353 and 356. PERA's defined benefit pension plans are tax qualified plans under Section 401(a) of the Internal Revenue Code.

General Employees Retirement Plan (General Employees Plan (accounted for in the General Employees Fund))

All full-time and certain part-time employees of the City are covered by the General Employees Plan. General Employees Plan members belong to the Coordinated Plan. Coordinated Plan members are covered by Social Security.

NOTE 11 – PENSION PLANS (CONTINUED)

Public Employees' Retirement Association (Continued)

A. Plan Description (Continued)

Public Employees Police and Fire Plan (Police and Fire Plan (accounted for in the Police and Fire Fund))

The Police and Fire Plan originally established for police officers and firefighters not covered by a local relief association, now covers all police officers and firefighters hired since 1980. Effective July 1, 1999, the Police and Fire Plan also covers police officers and firefighters belonging to a local relief association that elected to merge with and transfer assets and administration to PERA.

B. Benefits Provided

PERA provides retirement, disability, and death benefits. Benefit provisions are established by state statute and can only be modified by the state legislature.

Benefit increases are provided to benefit recipients each January. Increases are related to the funding ratio of the plan. Members in plans that are at least 90% funded for two consecutive years are given 2.5% increases. Members in plans that have not exceeded 90% funded, or have fallen below 80%, are given 1% increases.

The benefit provisions stated in the following paragraphs of this section are current provisions and apply to active plan participants. Vested, terminated employees who are entitled to benefits but are not receiving them, yet are bound by the provisions in effect at the time they last terminated their public service.

General Employees Plan Benefits

General Employees Plan benefits are based on a member's highest average salary for any five successive years of allowable service, age and years of credit at termination of service. Two methods are used to compute benefits for PERA's Coordinated Plan members. The retiring member receives the higher of a step-rate benefit accrual formula (Method 1) or a level accrual formula (Method 2). Under Method 1, the annuity accrual rate for a Coordinated Plan member is 1.2% of average salary for each of the first ten years and 1.7% for each remaining year. Under Method 2, the annuity accrual rate is 1.7% for Coordinated Plan members for each year of service. For members hired prior to July 1, 1989, a full annuity is available when age plus years of service equal 90 and normal retirement age is 65. For members hired on or after July 1, 1989, normal retirement age is the age for unreduced Social Security benefits capped at 66.

Police and Fire Plan Benefits

Benefits for the Police and Fire Plan members first hired after June 30, 2010, but before July 1, 2014, vest on a prorated basis from 50% after five years up to 100% after ten years of credited service. Benefits for Police and Fire Plan members first hired after June 30, 2014, vest on a prorated basis from 50% after ten years up to 100% after twenty years of credited service. The annuity accrual rate is 3% of average salary for each year of service. For Police and Fire Plan who were first hired prior to July 1, 1989, a full annuity is available when age plus years of service equal at least 90.

NOTE 11 – PENSION PLANS (CONTINUED)

Public Employees' Retirement Association (Continued)

C. Contributions

Minnesota Statutes Chapter 353 sets the rates for employer and employee contributions. Contribution rates can only be modified by the state legislature.

General Employees Plan Contributions

Coordinated Plan members were required to contribute 6.50% of their annual covered salary in calendar year 2017. The City was required to contribute 7.50% for Coordinated Plan members in calendar year 2017. The City's contributions to the General Employees Plan for the year ended December 31, 2017, were \$207,598. The City's contributions were equal to the required contributions as set by state statute.

Police and Fire Plan Contributions

Plan members were required to contribute 10.8% of their annual covered salary in calendar year 2017. The City was required to contribute 16.20% of pay for Police and Fire Plan members in calendar year 2017. The City's contributions to the Police and Fire Plan for the year ended December 31, 2017, were \$94,965. The City's contributions were equal to the required contributions as set by state statute.

D. Pension Costs

General Employees Plan Pension Costs

At December 31, 2017, the City reported a liability of \$2,655,717 for its proportionate share of the General Employees Plan's net pension liability. The City's net pension liability reflected a reduction due to the State of Minnesota's contribution of \$6 million to the fund in 2017. The State of Minnesota is considered a non-employer contributing entity and the State's contribution meets the definition of a special funding situation. The State of Minnesota's proportionate share of the net pension liability associated with the City totaled \$33,399. The net pension liability was measured as of June 30, 2017, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The City's proportion of the net pension liability was based on the City's contributions received by PERA during the measurement period for employer payroll paid dates from July 1, 2016, through June 30, 2017, relative to the total employer contributions received from all of PERA's participating employers. At June 30, 2017, the City's proportion share was 0.0416%, which was a decrease of 0.0011% from its proportion measured as of June 30, 2016.

For the year ended December 31, 2017, the City recognized pension expense of \$325,817 for its proportionate share of General Employees Plan's pension expense. Included in the amount, the City recognized \$965 for the year ended December 31, 2017 as pension expense (and grant revenue) for its proportionate share of the State of Minnesota's on behalf contributions to the plan.

NOTE 11 – PENSION PLANS (CONTINUED)

Public Employees' Retirement Association (Continued)

D. Pension Costs (Continued)

At December 31, 2017, the City reported its proportionate share of General Employees Plan's deferred outflows of resources and deferred inflows of resources, related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual economic experience	\$ 87,524	\$ 175,018
Changes in actuarial assumptions	452,564	266,235
Difference between projected and actual investment earnings	28,548	-
Changes in proportion	10,366	135,101
Contributions paid to PERA subsequent to the measurement date	<u>103,799</u>	<u>-</u>
	<u>\$ 682,801</u>	<u>\$ 576,354</u>

\$103,799 reported as deferred outflows of resources related to pensions resulting from City contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended December 31, 2018. Other amounts reported as deferred outflows and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Year Ending December 31,	Pension Expense Amount
2018	\$ 39,908
2019	144,866
2020	(69,396)
2021	<u>(112,730)</u>
Total	<u>\$ 2,648</u>

NOTE 11 – PENSION PLANS (CONTINUED)

Public Employees' Retirement Association (Continued)

D. Pension Costs (Continued)

Police and Fire Plan Pension Costs

At December 31, 2017, the City reported a liability of \$751,027 for its proportionate share of the Police and Fire Plan's net pension liability. The net pension liability was measured as of June 30, 2017, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The City's proportion of the net pension liability was based on the City's contributions received by PERA during the measurement period for employer payroll paid dates from July 1, 2016, through June 30, 2017, relative to the total employer contributions received from all of PERA's participating employers. At June 30, 2017, the City's proportion was 0.0560%, which was a decrease of 0.000% from its proportion measured as of June 30, 2016. The City also recognized \$5,040 for the year ended December 31, 2017 as revenue and an offsetting reduction of the net pension liability for its proportionate share of the State of Minnesota's on-behalf contributions to the Police and Fire Fund. Legislation passed in 2013 required the State of Minnesota to begin contributing \$9 million to the Police and Fire Fund each year, starting in fiscal year 2014.

For the year ended December 31, 2017, the City recognized pension expense of \$178,459 for its proportionate share of the Police and Fire Plan's pension expense.

At December 31, 2017, the City reported its proportionate share of the Police and Fire Plan's deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual economic experience	\$ 17,402	\$ 203,233
Changes in actuarial assumptions	989,464	1,073,428
Difference between projected and actual investment earnings	11,373	-
Changes in proportion	-	12,976
Contributions paid to PERA subsequent to the measurement date	<u>47,482</u>	<u>-</u>
	<u>\$ 1,065,721</u>	<u>\$ 1,289,637</u>

NOTE 11 –PENSION PLANS (CONTINUED)

Public Employees' Retirement Association (Continued)

D. Pension Costs (Continued)

\$47,482 reported as deferred outflows of resources related to pensions resulting from City contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended December 31, 2018. Other amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in pension expense as follows:

Year Ending December 31,	Pension Expense Amount
2018	\$ 9,593
2019	9,594
2020	(18,617)
2021	(60,763)
2022	(211,205)
Total	\$ (271,398)

E. Actuarial Assumptions

The total pension liability in the June 30, 2017, actuarial valuation was determined using the entry age normal actuarial cost method and the following actuarial assumptions:

Inflation	2.50 %	Per year
Active member payroll growth	3.25 %	Per year
Investment rate of return	7.50 %	

Salary increases were based on a service-related table. Mortality rates for active members, retirees, survivors, and disabled members were based on RP-2014 tables for all plans for males or females, as appropriate, with slight adjustments to fit PERA's experience. Cost of living benefit increases for retirees are assumed to be 1% per year for the General Employees plan through 2044 and the Police and Fire Plan through 2064 and then 2.5% thereafter for both plans.

Actuarial assumptions used in the June 30, 2017, valuation were based on the results of actuarial experience studies. The most recent four-year experience study in the General Employees Plan was completed in 2015. The most recent five-year experience study for Police and Fire Plan was completed in 2016.

NOTE 11 –PENSION PLANS (CONTINUED)

Public Employees' Retirement Association (Continued)

E. Actuarial Assumptions (Continued)

The following changes in actuarial assumptions occurred in 2017:

General Employees Fund

- The Combined Service Annuity (CSA) loads were changed from 0.8% for active members and 60% for vested and non-vested deferred members. The revised CSA loads are now 0.0% for active member liability, 1.5% for vested deferred member liability, and 3% for non-vested deferred member liability.
- The assumed post-retirement benefit increase rate was changed from 1% per year for all years to 1% per year through 2044 and 2.5% per year thereafter.

Police and Fire Fund

- Assumed salary increases were changed as recommended in the June 30, 2016 experience study. The net effect is proposed rates that average 0.34% lower than the previous rates.
- Assumed rates of retirement were changed, resulting in fewer retirements.
- The CSA load was 30% for vested and non-vested deferred members. The CSA has been changed to 33% for vested members and 2% for non-vested members.
- The base mortality table for healthy annuitants was changed from the RP-2000 fully generational table to the RP-2014 fully generational table (with a base year of 2006), with male rates adjusted by a factor of 0.96. The mortality improvement scale was changed from Scale AA to Scale MP-2016. The base mortality table for disabled annuitants was changed from the RP-2000 disabled mortality table to the mortality tables assumed for healthy retirees.
- Assumed termination rates were decreased to 3.0% for the first three years of service. Rates beyond the select period of three years were adjusted, resulting in more expected terminations overall.
- Assumed percentage of married female members was decreased from 65% to 60%.
- Assumed age difference was changed from separate assumptions for male members (wives assumed to be 3 years younger) and female members (husbands assumed to be 4 years older) to the assumption that males are 2 years older than females.
- The assumed percentage of female members electing Joint and Survivor annuities was increased.
- The assumed post-retirement benefit increase rate was changed from 1% for all years to 1% per year through 2064 and 2.5% thereafter.

NOTE 11 – PENSION PLANS (CONTINUED)

Public Employees' Retirement Association (Continued)

E. Actuarial Assumptions (Continued)

The State Board of Investment, which manages the investments of PERA, prepares an analysis of the reasonableness on a regular basis of the long-term expected rate of return using a building-block method in which best-estimate ranges of expected future rates of return are developed for each major asset class. These ranges are combined to produce an expected long-term rate of return by weighting the expected future rates of return by the target asset allocation percentages. The target allocation and best estimates of geometric real rates of return for each major asset class are summarized in the following table:

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
Domestic stocks	39 %	5.10 %
International stocks	19	5.30
Bonds	20	0.75
Alternative assets	20	5.90
Cash	2	0.00
Total	100 %	

F. Discount Rate

The discount rate used to measure the total pension liability in 2017 was 7.5%. The projection of cash flows used to determine the discount rate assumed that contributions from Plan members and employers will be made at rates set in *Minnesota Statutes*. Based on those assumptions, the fiduciary net position of the General Employees Fund and the Police and Fire Fund was projected to be available to make all projected future benefit payments of current Plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

NOTE 11 – PENSION PLANS (CONTINUED)

Public Employees' Retirement Association (Continued)

G. Pension Liability Sensitivity

The following table presents the City's proportionate share of the net pension liability for all plans it participates in, calculated using the discount rate disclosed in the preceding paragraph, as well as what the City's proportionate share of the net pension liability would be if it were calculated using a discount rate 1 percentage point lower or 1 percentage point higher than the current discount rate:

	1% Decrease in Discount Rate (6.5%)	Discount Rate (7.5%)	1% Increase in Discount Rate (8.5%)
City's proportionate share of the General Employees Fund net pension liability	\$ 4,119,214	\$ 2,655,717	\$ 1,457,578
	1% Decrease in Discount Rate (6.5%)	Discount Rate (7.5%)	1% Increase in Discount Rate (8.5%)
City's proportionate share of the Police and Fire Fund net pension liability	\$ 1,418,854	\$ 751,027	\$ 199,698

H. Pension Plan Fiduciary Net Position

Detailed information about each pension plan's fiduciary net position is available in a separately-issued PERA financial report that includes financial statements and required supplementary information. That report may be obtained on the Internet at www.mnpera.org.

Defined Benefit Pension Plan – Volunteer Fire Fighter's Relief Association

A. Plan Description

The Two Harbors Firefighter's Relief Association is the administrator of a single employer defined benefit pension plan established to provide benefits for members of the Two Harbors Fire Department per *Minnesota State Statutes*.

The Association issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to Two Harbors Firefighter's Association, 501 1st Avenue, Two Harbors, MN 55616 or by calling 218-834-8816.

NOTE 11 – PENSION PLANS (CONTINUED)

Defined Benefit Pension Plan – Volunteer Fire Fighter's Relief Association (Continued)

B. Benefits Provided

Volunteer firefighters of the City are members of the Two Harbors Fire Fighter's Relief Association. Full retirement benefits are payable to members who have reached age 50 and have completed 15 years of service for monthly service pension, or 10 years of service for lump sum service pension. Partial benefits are payable to members who have reached 50 and have completed 10 years of service. Disability benefits and widow and children's survivor benefits are also payable to members or their beneficiaries based upon requirements set forth in the bylaws. These benefit provisions and all other requirements are consistent with enabling state statutes.

C. Employees Covered by Benefit Terms

At December 31, 2016, the following employees were covered by the benefit terms:

Inactive employees or beneficiaries currently receiving benefits	6
Inactive employees entitled to but not yet receiving benefits	22
Active employees	28
Total	28

D. Contributions.

Minnesota Statutes Chapter 424A.092 specifies minimum support rates required on an annual basis. The minimum support rates from the municipality and from State aids are determined as the amount required to meet the normal cost plus amortizing any existing prior service costs over a ten-year period. The City's obligation is the financial requirement for the year less state aids. Any additional payments by the City shall be used to amortize the unfunded liability of the relief association. The Association is comprised of volunteers; therefore, there are no payroll expenditures (i.e. there are no covered payroll percentage calculations). During the year, the City recognized as revenue and as an expenditure an on behalf payment of \$51,961 made by the State of Minnesota for the Relief Association.

E. Net Pension Liability

The City's net pension liability was measured as of December 31, 2016, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date.

NOTE 11 – PENSION PLANS (CONTINUED)

Defined Benefit Pension Plan – Volunteer Fire Fighter's Relief Association (Continued)

E. Net Pension Liability (Continued)

Actuarial assumptions:

The total pension liability in the December 31, 2016, actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	2.75 %
Salary increase	N/A % average, including inflation
Investment rate of return	6.75 %, net of pensions plan investment expenses, including inflation

The value of death benefits is similar to the value of the retirement pension. Because of low retirement ages, the plan assumes no pre-retirement mortality. Post-retirement mortality does not apply as the benefit structure and form of payment do not reflect lifetime benefits.

The long-term return on assets has been set based on the plan's target investment allocation along with long-term return expectations by asset class. When there is sufficient historical evidence of market outperformance, historical average returns may be considered. Best estimates of arithmetic real rates of return for each major asset class included in the pension plan's target asset allocation as of the measurement date are summarized in the table below.

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
Domestic equity	30.63 %	5.58 %
International equity	16.34	5.71
Fixed income	52.73	2.27
Real estate and alternatives	0.00	4.44
Cash and equivalents	0.30	0.84
Total	100.00 %	

Discount rate

The discount rate used to measure the total pension liability was 6.75%. Assets were projected using expected benefit payments and expected asset returns. Expected benefit payments by year were discounted using the expected asset return assumption for years in which the assets were sufficient to pay all benefit payments. Any remaining benefit payments after the trust fund is exhausted are discounted at the municipal bond rate. The equivalent single rate is the discount rate.

NOTE 11 – PENSION PLANS (CONTINUED)

Defined Benefit Pension Plan – Volunteer Fire Fighter's Relief Association (Continued)

F. Changes in the Net Pension Liability

	Total Pension Liability (a)	Increase (Decrease) Plan Fiduciary Net Position (b)	Net Pension Liability (a) - (b)
Balances at January 1, 2016	\$ 682,124	\$ 748,907	\$ (66,783)
Changes for the year			
Service cost	47,135	-	47,135
Interest cost	37,453	-	37,453
Differences between expected and actual experience	(45,192)	-	(45,192)
Changes of assumptions	(21,800)	-	(21,800)
Changes of benefit terms	-	-	-
State contributions	-	54,261	(54,261)
Contributions - donations and other income	-	(6,390)	6,390
Net investment income	-	48,110	(48,110)
Other addition	-	1,201	(1,201)
Benefit payments	(155,812)	(155,812)	-
Administrative expense	-	(7,301)	7,301
Net changes	(138,216)	(65,931)	(72,285)
Balances at December 31, 2016	\$ 543,908	\$ 682,976	\$ (139,068)

Sensitivity of the net pension liability to changes in the discount rate. The following presents the net pension liability of the City, calculated using the discount rate of 6.75%, as well as what the City's net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (5.75%) or 1-percentage-point higher (7.75%) than the current rate:

	Current Discount Rate 6.75%	1% Decrease 5.75%	1% Increase 7.75%
City's net pension liability	\$ (139,068)	\$ (117,268)	\$ (160,038)

Pension plan fiduciary net position. Detailed information about the pension plan's fiduciary net position is available in the separately issued relief association financial report.

NOTE 11 – PENSION PLANS (CONTINUED)

Defined Benefit Pension Plan – Volunteer Fire Fighter's Relief Association (Continued)

F. Changes in the Net Pension Liability

	Total Pension Liability (a)	Increase (Decrease) Plan Fiduciary Net Position (b)	Net Pension Liability (a) - (b)
Balances at January 1, 2016	\$ 682,124	\$ 748,907	\$ (66,783)
Changes for the year			
Service cost	47,135	-	47,135
Interest cost	37,453	-	37,453
Differences between expected and actual experience	(45,192)	-	(45,192)
Changes of assumptions	(21,800)	-	(21,800)
Changes of benefit terms	-	-	-
State contributions	-	54,261	(54,261)
Contributions - donations and other income	-	(6,390)	6,390
Net investment income	-	48,110	(48,110)
Other addition	-	1,201	(1,201)
Benefit payments	(155,812)	(155,812)	-
Administrative expense	-	(7,301)	7,301
Net changes	(138,216)	(65,931)	(72,285)
Balances at December 31, 2016	\$ 543,908	\$ 682,976	\$ (139,068)

Sensitivity of the net pension liability to changes in the discount rate. The following presents the net pension liability of the City, calculated using the discount rate of 6.75%, as well as what the City's net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (5.75%) or 1-percentage-point higher (7.75%) than the current rate:

	Current Discount Rate 6.75%	1% Decrease 5.75%	1% Increase 7.75%
City's net pension liability	\$ (139,068)	\$ (117,268)	\$ (160,038)

Pension plan fiduciary net position. Detailed information about the pension plan's fiduciary net position is available in the separately issued relief association financial report.

NOTE 11 – PENSION PLANS (CONTINUED)

Defined Benefit Pension Plan – Volunteer Fire Fighter's Relief Association (Continued)

G. Pension Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

For the year ended December 31, 2017, the City recognized pension expense of \$6,082. At December 31, 2017, the City reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	\$ -	\$ 40,425
Changes of assumptions	37,700	19,500
Net difference between projected and actual earnings on pension plan investments	17,541	-
City's contributions to relief association subsequent to measurement date	49,545	-
Total	\$ 104,786	\$ 59,925

\$49,545 reported as deferred outflows of resources related to pensions resulting from the City's contribution to the relief association subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended December 31, 2018. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as shown on the following page.

	Year Ending	Total
	2018	\$ 4,426
	2019	4,424
	2020	5,108
	2021	(3,201)
	2022	(1,696)
	Thereafter	(13,745)
Total		\$ (4,684)

H. Payable to the Pension Plan

At December 31, 2017, the City reported a payable of \$0 for the outstanding amount of contributions to the pension plan required for the year ended December 31, 2017.

NOTE 12 – POST EMPLOYMENT HEALTH CARE PLAN (CONTINUED)

D. Funded Status and Funding Progress

As of January 1, 2015, the most recent actuarial valuation date, the City had no assets deposited to fund the plan. The actuarial accrued liability for benefits was \$2,478,745 and the actuarial value of assets was \$0, resulting in an unfunded actuarial accrued liability (UAAL) of \$2,478,745. The covered payroll (annual payroll of active employees covered by the plan) was \$3,147,975 and the ratio of the UAAL to the covered payroll was 78.7%.

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the ARC of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

The Schedule of Funding Progress – Other Post Employment Benefits, presented as required supplementary information following the notes to financial statements, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

E. Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities, consistent with the long-term perspective of the calculations.

As of January 1, 2015, the actuarial valuation date, the projected unit credit with 30 year amortization of the unfunded liability method was used. The actuarial assumptions included a 3.5% discount rate based on investment yield. The City currently does not plan to prefund for this benefit. At the actuarial valuation date, the annual health care cost trend rate was calculated to be 7.2% initially, reduced incrementally to an ultimate rate of 5.0% in 8 years. The UAAL is being amortized as a level dollar amount on an open basis. The remaining amortization period at January 1, 2015, was 30 years.

NOTE 13 – NEW STANDARDS ISSUED BUT NOT YET IMPLEMENTED

GASB has issued GASB statement 75 relating to accounting and financial reporting for postemployment benefits other than pensions. The new statement requires governments in all types of OPEB plans to present more extensive note disclosures and required supplementary information (RSI) about OPEB liabilities. This statement will be effective for the year ending December 31, 2018.

NOTE 12 – POST EMPLOYMENT HEALTH CARE PLAN

A. Plan Description

The City provides single-employer defined benefit health care insurance and life insurance upon retirement to certain retirees. Medical coverage is administered by Blue Cross/Blue Shield. It is the City's policy to periodically review its medical coverage, and to obtain requests for proposals in order to provide the most favorable benefits and premiums for city employees and retirees.

B. Funding Policy

Retirees contribute to the health care plan at the same rate as City employees. This results in the retiree receiving an implicit rate subsidy. Contribution requirements are established by the City, based on the contract terms with Blue Cross/Blue Shield. The required contributions are based on projected pay-as-you-go financing requirements. For fiscal year 2017, the City contributed \$250,838 to the plan. As of December 31, 2017, there were seven retirees receiving health benefits from the City's health plan.

C. Annual Other Post Employment Benefits Cost and Net Other Post Employment Benefits Costs Obligations

The City's annual Other Post Employment Benefits (OPEB) cost (expense) is calculated based on the annual required contribution (ARC) of the City, an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal costs each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years. The following table shows the components of the City's annual OPEB costs for the year; the amount actually contributed to the plan and changes in the City's net OPEB obligation to the plan.

ARC	\$ 278,202
Interest on Net OPEB Obligation	33,554
Adjustment to ARC	(52,125)
Annual OPEB Cost	<u>259,631</u>
Contributions Made	250,838
Increase in Net OPEB Obligation	<u>8,793</u>
Net OPEB Obligation - Beginning of Year	958,680
Net OPEB Obligation - End of Year	<u>\$ 967,473</u>

The City's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan and the net OPEB obligation for 2015, 2016, and 2017 were as follows:

Year Ended	Annual OPEB Cost	Employer Contribution	Percentage of	
			Annual OPEB Cost Contributed	Net OPEB Obligation
12/31/2015	\$ 258,160	\$ 132,188	51.2%	\$ 933,053
12/31/2016	260,682	235,055	90.2%	958,680
12/31/2017	259,631	250,838	96.6%	967,473

City of Two Harbors
Notes to Financial Statements

NOTE 13 – NEW STANDARDS ISSUED BUT NOT YET IMPLEMENTED (CONTINUED)

GASB Statement No. 87, Leases establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities. This statement will be effective for the year ending December 31, 2020.

NOTE 14 – CONTINGENCIES

In the normal course of business the City is subject to various claims and litigation. As of December 31, 2017, the City believes these claims and litigation will not have a material impact on the financial statements.

NOTE 15 – PRIOR PERIOD ADJUSTMENT

For the year ended December 31, 2017, a prior period adjustment was required to adjust beginning net position for the Campground Fund to account for deferred revenue that should have been recorded for campsite fees during the year ended December 31, 2016. This affected the beginning net position for in the amount of \$35,795.

**City of Two Harbors
Schedule of Funding Progress – Other Post Employment Benefits
December 31, 2017**

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Simplified Entry Age (b)	Unfunded AAL (UAAAL) (b - a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAAL as a Percentage of Covered Payroll ((b - a) / c)
01/01/15	\$ -	\$ 2,478,745	\$ 2,478,745	0%	\$ 3,147,975	78.4%
01/01/12	-	2,319,806	2,319,806	0%	3,295,505	70.4%
01/01/07	-	1,677,298	1,677,298	0%	2,536,635	66.1%

**City of Two Harbors
Schedule of City's Proportionate Share of Net Pension Liability
General Employees Retirement Fund
Last Ten Years**

For Fiscal Year Ended June 30,	City's Proportionate Share of the Net Pension Liability (As a Percentage of the Net Pension Liability (Asset))	City's Proportionate Share (Amount) of the Net Pension Liability (As a Percentage of the Net Pension Liability (Asset))	State's Proportionate Share of the Net Pension Liability Associated with the City	City's Proportionate Share of the Net Pension Liability and the State's Share of the Net Pension Liability Associated with the City	City's Covered Payroll	City's Proportionate Share of its Covered Payroll	Plan Fiduciary Net Position as a Percentage of the Total Pension Liability
2017	0.0416%	\$ 2,655,717	\$ 33,399	\$ 2,689,116	\$ 2,680,387	99.98%	75.90%
2016	0.0423%	2,456,563	43,233	2,500,000	2,496,887	99.83%	76.15%
2015	0.0423%	2,192,206	-	2,192,206	2,446,937	89.59%	78.19%

Note: Schedule is intended to show ten year trend. Additional years will be reported as they become available.

**Schedule of City's Proportionate Share of Net Pension Liability
Public Employees Police and Fire Retirement Fund
Last Ten Years**

For Fiscal Year Ended June 30,	City's Proportionate Share of the Net Pension Liability (As a Percentage of the Net Pension Liability (Asset))	City's Proportionate Share (Amount) of the Net Pension Liability (As a Percentage of the Net Pension Liability (Asset))	City's Covered Payroll	City's Proportionate Share of its Covered Payroll	Plan Fiduciary Net Position as a Percentage of the Total Pension Liability
2017	0.0560%	\$ 751,027	\$ 571,259	131.47%	85.43%
2016	0.0560%	2,247,377	535,369	419.83%	63.88%
2015	0.0570%	647,653	510,543	126.86%	86.61%

Note: Schedule is intended to show ten year trend. Additional years will be reported as they become available.

City of Two Harbors
Schedule of City Contributions
General Employees Retirement Fund
Last Ten Years

Fiscal Year Ending December 31,	Statutorily Required Contribution	Contributions in Relation to the Statutorily Required Contributions	Contribution Deficiency (Excess)	City's Covered Payroll	Contributions as a Percentage of Covered Payroll
2017	\$ 207,598	\$ 207,598	\$ -	\$ 2,767,973	7.5%
2016	201,922	201,922	-	2,692,293	7.5%
2015	194,488	194,488	-	2,593,160	7.5%

Note: Schedule is intended to show ten year trend. Additional years will be reported as they become available.

Schedule of City Contributions
Public Employees Police and Fire Retirement Fund
Last Ten Years

Fiscal Year Ending December 31,	Statutorily Required Contribution	Contributions in Relation to the Statutorily Required Contributions	Contribution Deficiency (Excess)	City's Covered Payroll	Contributions as a Percentage of Covered Payroll
2017	\$ 94,965	\$ 94,965	\$ -	\$ 586,204	16.2%
2016	90,946	90,946	-	561,395	16.2%
2015	85,621	85,621	-	528,524	16.2%

Note: Schedule is intended to show ten year trend. Additional years will be reported as they become available.

City of Two Harbors
Schedule of Changes in Net Pension Liability
and Related Ratios - Fire Relief Association

	2016	2015	2014
Total Pension Liability (TPL)			
Service cost	\$ 47,135	\$ 35,852	\$ 34,892
Interest	37,453	34,576	32,879
Differenced between expected and actual experience	(45,192)	-	-
Changes of assumptions	(21,800)	48,442	-
Changes of benefit terms	-	36,986	-
Benefit payments, including refunds or member contributions	(155,812)	(78,417)	-
Net change in total pension liability	(138,216)	77,439	67,771
Beginning of year	682,124	604,685	536,914
End of Year	\$ 543,908	\$ 682,124	\$ 604,685

Plan Fiduciary Net Position (FNP)

Contributions - employer	\$ 54,261	\$ 51,722	\$ 64,861
Contributions - donations and other income	(6,390)	6,390	-
Contributions - employee	-	-	-
Net investment income	48,110	(1,150)	43,924
Other additions	1,201	-	-
Benefit payments, including refunds of member contributions	(155,812)	(78,417)	-
Administrative expense	(7,301)	(7,080)	(6,700)
Other	-	(200)	-
Net change in plan fiduciary net position	(65,931)	(28,735)	102,085
Beginning of year	748,907	777,642	675,557
End of year	\$ 682,976	\$ 748,907	\$ 777,642

Net Pension Liability (NPL)	\$ (139,068)	\$ (66,783)	\$ (172,957)
Plan Fiduciary Net Position as a percentage of the total pension liability	125.6%	109.8%	128.6%
Covered Employee Payroll	N/A	N/A	N/A
Net Pension Liability as a percentage of Covered Payroll	N/A	N/A	N/A

The City implemented the Provisions of Governmental Accounting Standards Board Statement No. 68 for the year ended December 31, 2015. The schedules within the Required Supplementary Information section required a ten year presentation, but does not require retroactive reporting. Information prior to 2014 is not available.

City of Two Harbors
Notes to Required Supplementary Information

City of Two Harbors
Schedule of Employer Contributions
and Non-Employer Contributing
Entities - Fire Relief Association

	2016	2015	2014
Employer			
Statutorily determined contribution (SDC)	\$ -	\$ -	\$ -
Contribution made	(2,300)	(2,300)	(2,300)
Contribution deficiency (excess)	\$ (2,300)	\$ (2,300)	\$ (2,300)
Non-employer			
2% aid	\$ 51,961	\$ 49,422	\$ 62,531

The City implemented the Provisions of Governmental Accounting Standards Board Statement No. 68 for the year ended December 31, 2015. The schedules within the Required Supplementary Information section required a ten-year presentation, but does not require retroactive reporting. Information prior to 2014 is not available.

GENERAL EMPLOYEES FUND

2017 Changes

Changes in Actuarial Assumptions

- The CSA loads were changed from 0.8% for active members and 60% for vested and non-vested deferred members. The revised CSA loads are now 0.0% for active member liability, 15% for vested deferred member liability and 3% for non-vested deferred member liability.
- The assumed post-retirement benefit increase rate was changed from 1.0% per year for all years to 1.0% per year through 2044 and 2.5% per year thereafter.

2016 Changes

Changes in Actuarial Assumptions

- The assumed post-retirement benefit increase rate was changed from 1.0% per year through 2035 and 2.5% per year thereafter to 1.0% per year for all future years.
- The assumed investment return was changed from 7.9% to 7.5%. The single discount rate was changed from 7.9% to 7.5%.
- Other assumptions were changed pursuant to the experience study dated June 30, 2015. The assumed future salary increases, payroll growth, the inflation were decreased by 0.25% to 3.25% for payroll growth and 2.50% for inflation.

2015 Changes

Changes in Plan Provisions

- On January 1, 2015, the Minneapolis Employees Retirement Fund was merged into the General Employees Fund, which increased the total pension liability by \$1.1 billion and increased the fiduciary plan net position by \$892 million. Upon consolidation, state and employer contributions were revised.

Changes in Actuarial Assumptions

- The assumed post-retirement benefit increase rate was changed from 1.0% per year through 2030 and 2.5% per year thereafter to 1.0% per year through 2035 and 2.5% per year thereafter.

POLICE AND FIRE FUND

2017 Changes

Changes in Actuarial Assumptions

- Assumed salary increases were changed as recommended in the June 30, 2016 experience study. The net effect is proposed rates that average 0.34% lower than the previous rates.
- Assumed rates of retirement were changed, resulting in fewer retirements.
- The CSA load was 30% for vested and non-vested deferred members. The CSA has been changed to 33% for vested members and 2% for non-vested members.

**City of Two Harbors
Notes to Required Supplementary Information**

POLICE AND FIRE FUND (CONTINUED)

2017 Changes (Continued)

Changes in Actuarial Assumptions (Continued)

- The base mortality table for healthy annuitants was changed from the RP-2000 fully generational table to the RP-2014 fully generational table (with a base year of 2006), with male rates adjusted by a factor of 0.96. The mortality improvement scale was changed from Scale AA to Scale MP-2016. The base mortality table for disabled annuitants was changed from the RP-2000 disabled mortality table to the mortality tables assumed for healthy retirees.
- Assumed termination rates were decreased to 3% for the first three years of service. Rates beyond the select period of three years were adjusted, resulting in more expected terminations overall.
- Assumed percentage of married female members was decreased from 65% to 60%.
- Assumed age difference was changed from separate assumptions for male members (wives assumed to be 3 years younger) and female members (husbands assumed to be 4 years older) to the assumption that males are 2 years older than females.
- The assumed percentage of female members electing Joint and Survivor annuities was increased.
- The assumed post-retirement benefit increase rate was changed from 1% for all years to 1% per year through 2064 and 2.5% thereafter.

2016 Changes

Changes in Actuarial Assumptions

- The assumed post-retirement benefit increase rate was changed from 1.0% per year through 2037 and 2.5% thereafter to 1.0% per year for all future years.
- The assumed investment return was changed from 7.9% to 7.5%. The single discount rate changed from 7.9% to 5.6%.
- The assumed future salary increases, payroll growth, and inflation were decreased by 0.25% to 3.25% for payroll growth and 2.50% for inflation.

2015 Changes

Changes in Plan Provisions

- The post-retirement benefit increase to be paid after attainment of the 90% funding threshold was changed, from inflation up to 2.5%, to a fixed rate of 2.5%.

Changes in Actuarial Assumptions

- The assumed post-retirement benefit increase rate was changed from 1.0% per year through 2030 and 2.5% per year thereafter to 1.0% per year through 2037 and 2.5% per year thereafter.

SUPPLEMENTARY INFORMATION

City of Two Harbors
Schedule of Revenues, Expenditures, and
Changes in Fund Balance -
Budget and Actual - General Fund
Year Ended December 31, 2017

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Over (Under)
	Original	Final		
Revenues				
Taxes				
General property taxes	\$ 1,693,078	\$ 1,693,078	\$ 1,328,692	\$ (364,386)
Cable television franchise tax	31,378	31,378	29,344	(2,034)
Total taxes	1,724,456	1,724,456	1,358,036	(366,420)
Special assessments	17,617	17,617	11,319	(6,298)
Licenses and permits	40,093	40,093	38,548	(1,545)
Intergovernmental revenues				
State grants and aids				
Local government aid	1,525,084	1,525,084	1,525,084	-
Taconite aid	-	-	156,462	156,462
State grant	13,250	13,250	33,647	20,397
State fire aid	44,300	44,300	49,545	5,245
State police aid	63,805	63,805	66,479	2,674
County highway grants	11,000	11,000	5,500	(5,500)
Other grants and aids	7,000	7,000	196,903	189,903
Total intergovernmental revenues	1,664,439	1,664,439	2,033,620	369,181
Charges for services				
Fire contract	133,263	133,263	133,381	118
Cemetery services	31,310	31,310	43,751	12,441
Snow removal	-	-	1,554	1,554
Other	29,900	29,900	38,391	8,491
Total charges for services	194,473	194,473	217,077	22,604
Fines and forfeitures	13,900	13,900	17,591	3,691
Miscellaneous revenues				
Investment income	3,200	3,200	6,656	3,456
Other	13,381	13,381	13,006	(375)
Total miscellaneous revenues	16,581	16,581	19,662	3,081
Total revenues	3,671,559	3,671,559	3,695,853	24,294

City of Two Harbors
Schedule of Revenues, Expenditures, and
Changes in Fund Balance -
Budget and Actual - General Fund
Year Ended December 31, 2017

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Over (Under)
	Original	Final		
Expenditures				
General government				
Mayor and council	\$ 86,435	\$ 86,435	\$ 71,402	\$ (15,033)
Administrative and finance	356,450	356,450	300,587	(55,863)
Other general government	231,675	231,675	181,884	(49,791)
Total general government	674,560	674,560	553,873	(120,687)
Public safety				
Police				
Current	1,022,325	1,022,325	994,753	(27,572)
Total police	1,022,325	1,022,325	994,753	(27,572)
Fire				
Current	182,274	182,274	201,211	18,937
Capital outlay	-	-	52,487	52,487
Total fire	182,274	182,274	253,698	71,424
Animal control				
Current	11,600	11,600	10,551	(1,049)
Other				
Current	5,150	5,150	6,917	1,767
Total public safety	1,221,349	1,221,349	1,265,919	44,570
Public works				
Streets and highways				
Street maintenance	1,053,015	1,053,015	1,001,986	(51,029)
Street signs	10,000	10,000	9,336	(664)
Equipment maintenance	30,000	30,000	46,102	16,102
Total streets and highways	1,093,015	1,093,015	1,057,424	(35,591)
Sanitation				
Waste removal	38,000	38,000	29,760	(8,240)
Tree removal	8,000	8,000	2,354	(5,646)
Total sanitation	46,000	46,000	32,114	(13,886)
Total public works	1,139,015	1,139,015	1,089,538	(49,477)
Culture and recreation				
Current expenditures	196,487	196,487	186,541	(9,946)
Capital outlay	5,000	5,000	-	(5,000)
Total culture and recreation	201,487	201,487	186,541	(14,946)
Health and welfare				
Cemetery				
Current	101,674	101,674	91,135	(10,539)

City of Two Harbors
 Schedule of Revenues, Expenditures, and
 Changes in Fund Balance -
 Budget and Actual - General Fund
 Year Ended December 31, 2017

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Over (Under)
	Original	Final		
Expenditures (Continued)				
Miscellaneous	\$ 219,255	\$ 219,255	\$ 217,248	\$ (2,007)
Debt service				
Principal	118,032	118,032	118,032	-
Interest and other charges	11,565	11,565	11,565	-
Total debt service	129,597	129,597	129,597	-
Total expenditures	3,686,937	3,686,937	3,553,851	(133,086)
Excess of revenues over (under) expenditures	(15,378)	(15,378)	162,002	177,380
Other Financing Sources (Uses)				
Proceeds from sale of capital asset	-	-	12,451	12,451
Insurance Proceeds	-	-	50,724	50,724
Transfers in	342,019	342,019	376,470	34,451
Transfers out	(454,734)	(454,734)	(478,619)	(23,885)
Total other financing sources (uses)	(112,715)	(112,715)	(38,974)	73,741
Net change in fund balance	\$ (128,093)	\$ (128,093)	123,028	\$ 251,121
Fund Balance				
Beginning of year			1,859,336	
End of year			\$ 1,982,364	

City of Two Harbors
 Combining Balance Sheet -
 Nonmajor Governmental Funds
 December 31, 2017

	Special Revenue					
	Library (211)	Airport (231)	Local Sales Tax (261)	Tax Increment Financing (251)	Revolving Loan Fund SCDP (205)	Total
Assets						
Cash and investments	\$ 116,864	\$ 8,418	\$ 594,609	\$ 277,471	\$ 80,004	\$ 1,063,948
Accounts receivable	927	-	35,701	-	-	45,046
Interest receivable	-	-	270	905	336	1,511
Due from other governments	-	13,577	-	-	-	13,577
Notes receivable	-	19,195	-	-	-	19,195
Inventories	-	-	-	-	-	-
Total assets	\$ 117,791	\$ 41,190	\$ 630,580	\$ 273,376	\$ 80,340	\$ 1,143,277
Liabilities						
Accounts payable	\$ 3,621	\$ 2,007	\$ -	\$ -	\$ -	\$ 5,628
Contracts payable	-	4,580	-	-	-	4,580
Due to other funds	-	-	-	-	-	-
Accrued payroll	6,717	1,065	-	-	-	6,717
Unearned revenue	-	-	-	-	-	-
Total liabilities	10,338	7,652	-	-	-	17,990
Fund Balances						
Respendable	-	19,195	-	-	-	19,195
Restricted	97,711	14,345	630,580	273,376	80,340	984,296
Committed	9,742	-	-	-	-	112,004
Assigned	-	-	-	-	-	-
Unassigned	-	-	-	-	-	-
Total fund balances	107,453	33,538	630,580	273,376	80,340	1,125,287
Total liabilities and fund balances	\$ 117,791	\$ 41,190	\$ 630,580	\$ 273,376	\$ 80,340	\$ 1,143,277

City of Two Harbors
 Combining Statement of Revenues, Expenditures, and Changes
 in Fund Balances - Nonmajor Governmental Funds
 Year Ended December 31, 2017

	Special Revenue					Total
	Library (211)	Airport (231)	Local Sales Tax (261)	Tax Increment Financing (251)	Revolving Loan Fund SCDP (205)	
Revenues						
Sales tax						
Intergovernmental			\$ 278,873			\$ 278,873
State grants and aid	3,060	29,611				32,671
County grants and aid	45,000	4,000				49,000
Special library system	5,200					5,200
Charges for services	7,276	122,439				129,715
Miscellaneous						
Investment income			8,495	3,021	645	12,161
Contributions and donations	17,637					17,637
Loan payments						
Other	3,526					3,526
Total revenues	81,228	156,050	287,368	3,021	645	528,312
Expenditures						
Current						
Culture and recreation	266,874					266,874
Economic development				75,453		75,453
Administration					10,000	10,000
Capital outlay		144,157				144,157
General government						
Public works						
Total expenditures	266,874	144,157		75,453	10,000	496,484
Excess of revenues over (under) expenditures	(185,646)	11,893	287,368	(72,432)	(9,355)	31,828
Other Financing Sources (Uses)						
Proceeds from sale of capital asset	185,646					185,646
Transfers in		1,449				1,449
Transfers out			(400,000)			(400,000)
Total other financing sources (uses)	185,646	1,449	(400,000)	(41,001)	(41,001)	(254,906)
Net change in fund balances		13,342	(112,632)	(113,833)	(9,355)	(222,478)
Fund Balances						
Beginning of year	107,453	20,196	743,212	487,209	89,695	1,347,765
End of year	\$ 107,403	\$ 33,538	\$ 630,580	\$ 373,376	\$ 80,340	\$ 1,125,237

	Capital Projects				Total Governmental Funds
	Edna G. Restoration Project (411)	Permanent Improvements (500)	Capital Equipment Fund (401)	Street Improvement Fund (402)	
Permanent					
Cemetery Perpetual (810)					
\$ 145,928	\$ 255,512	\$ -	\$ 195,541	\$ 451,023	\$ 1,660,929
240					45,286
824	219			219	2,554
	476,830			476,830	440,407
	188,850			188,850	188,850
					19,195
Total	\$ 255,731	\$ 615,680	\$ -	\$ 195,541	\$ 2,357,721
\$ -	\$ -	\$ 48,564	\$ 30,672	\$ 79,236	\$ 84,864
		16,188		16,188	16,188
		165,489	59,903	225,392	229,972
		188,850		188,850	6,717
		419,091	59,903	30,672	189,915
					527,656
146,992					19,195
					1,131,288
					112,054
	255,731	196,389	164,869	617,189	616,931
146,992	255,731	196,389	164,869	59,903	659,933
					1,829,462
\$ 146,992	\$ 255,731	\$ 615,680	\$ 195,541	\$ 1,066,952	\$ 2,357,721

City of Two Harbors
Statement of Changes in Agency Fund Assets and Liabilities -
Two Harbors Convention and Visitors Bureau
December 31, 2017

Assets	Beginning of Year	Additions	Deductions	End of Year
Current				
Cash and investments	\$ 89,143	\$ 149,357	\$ 130,828	\$ 107,672
Other receivables	6,402	7,152	6,402	7,152
Total assets	<u>\$ 95,545</u>	<u>\$ 156,509</u>	<u>\$ 137,230</u>	<u>\$ 114,824</u>
Liabilities				
Accounts payable	<u>\$ 95,545</u>	<u>\$ 135,265</u>	<u>\$ 115,986</u>	<u>\$ 114,824</u>

	Capital Projects					Total Governmental Funds
	Edna G. Restoration Project (411)	Permanent Improvements (500)	Capital Equipment Fund (401)	Street Improvement Fund (402)	Total	
1,298	\$ 49,714	\$ 444,160	\$ -	\$ 23,681	\$ 467,841	\$ 500,512
	420	5,805	-	-	6,225	179,504
	-	-	-	-	-	13,879
	-	-	-	-	-	17,637
	-	-	-	-	-	5,805
1,298	<u>50,134</u>	<u>450,040</u>	<u>-</u>	<u>23,681</u>	<u>523,855</u>	<u>7,526</u>
	-	-	-	-	-	266,874
	-	-	-	-	-	86,153
	-	-	-	-	-	144,157
	1,243	451,659	150,753	96,622	548,281	151,996
	1,243	451,659	150,753	96,622	700,277	548,281
1,298	<u>48,891</u>	<u>(1,619)</u>	<u>(150,753)</u>	<u>(72,941)</u>	<u>(176,622)</u>	<u>(143,296)</u>
	-	-	-	-	-	1,449
(667)	-	-	90,850	237,810	328,660	414,606
(667)	-	-	-	-	-	(442,088)
631	<u>48,891</u>	<u>(1,619)</u>	<u>(90,850)</u>	<u>237,810</u>	<u>328,660</u>	<u>73,687</u>
	-	-	-	-	-	164,869
	-	-	-	-	-	152,238
146,361	<u>206,810</u>	<u>198,208</u>	<u>-</u>	<u>-</u>	<u>405,018</u>	<u>1,899,174</u>
146,992	<u>\$ 355,731</u>	<u>\$ 196,589</u>	<u>\$ (59,903)</u>	<u>\$ 164,869</u>	<u>\$ 557,286</u>	<u>\$ 1,829,565</u>

City of Two Harbors
 Balance Sheet - Component Unit -
 Two Harbors Development Fund
 December 31, 2017

Assets	
Cash and investments	\$ 146,987
Accounts Receivable	220
Loans receivable	641,709
	<u>788,916</u>
Total assets	193,220
Deferred Inflows of Resources	
Deferred inflows - loans receivable	
Fund Balance	
Committed	<u>595,696</u>
Total liabilities, deferred inflows of resources and fund balance	<u>\$ 788,916</u>
Reconciliation of the balance sheet to the statement of net position	
Fund balance	\$ 595,696
Loans receivable will be collected in future years but are not available to pay for current period expenditures	<u>193,220</u>
Net position	<u>\$ 788,916</u>

City of Two Harbors
 Schedule of Revenues, Expenditures, and
 Changes in Fund Balance - Component Unit -
 Two Harbors Development Fund
 Year Ended December 31, 2017

Revenues	
Miscellaneous	\$ 8,982
Principal payments on loans	13,513
Interest on loans	88
Investment income	500
Other	<u>23,083</u>
Total revenues	
Expenditures	
Current	
Insurance	630
Professional services	20,000
Legal fees	3,521
Total expenditures	<u>24,151</u>
Excess of revenues over expenditures	(1,068)
Fund Balance	
Beginning of year	<u>596,764</u>
End of year	<u>\$ 595,696</u>
Reconciliation of the schedule of revenues, expenditures, and changes in fund balance to the Statement of Activities	
Net change in fund balance	\$ (1,068)
Principal payments on loans receivable are recognized as revenues in the governmental funds but have no effect on net position in the Statement of Activities.	
Principal payments	<u>(8,982)</u>
Change in net position	<u>\$ (10,050)</u>

City of Two Harbors
 Balance Sheet - Component Unit -
 Two Harbors Economic Development Authority
 December 31, 2017

Assets	
Cash and investments	\$ <u>27,486</u>
Fund Balance	
Committed	\$ <u>27,486</u>

City of Two Harbors
 Schedule of Revenues, Expenditures, and
 Changes in Fund Balance - Component Unit -
 Two Harbors Economic Development Authority
 Year Ended December 31, 2017

Revenues	
Contributions and donations	\$ 10,000
Expenditures	
Current	
Professional services	11,031
Dues and subscriptions	2,063
Total expenditures	<u>13,094</u>
Excess of revenues over expenditures	(3,094)
Fund Balance	
Beginning of year	<u>30,580</u>
End of year	<u>\$ 27,486</u>



**Report on Internal Control over Financial Reporting
and on Compliance and Other Matters Based on an Audit of
Financial Statements Performed in Accordance With
Government Auditing Standards**

Independent Auditor's Report

Honorable Mayor and Members
of the City Council
City of Two Harbors
Two Harbors, Minnesota

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund and the aggregate remaining fund information of the City of Two Harbors, Minnesota as of and for the year ended December 31, 2017, and the related notes to financial statements, which collectively comprise the City's basic financial statements, and have issued our report thereon dated April 16, 2018.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the City's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the City's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.



Internal Control over Financial Reporting (Continued)

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did identify certain deficiencies in internal control, described in the accompanying Schedule of Findings and Responses on Internal Control as audit finding 2006-001 and 2016-001, that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

City's Response to Findings

The City's response to the finding identified in our audit is described in the accompanying Schedule of Findings. The City's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the City's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the City's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

BergankDV Ltd.

Minneapolis, Minnesota
April 16, 2018

City of Two Harbors
Schedule of Findings and Responses on Internal Control

CURRENT AND PRIOR YEAR INTERNAL CONTROL FINDING:

Material Weaknesses:

Audit Finding 2006-001 - Lack of Segregation of Duties

During the year ended December 31, 2017, the City had a lack of segregation of accounting duties due to a limited number of office employees. The lack of adequate segregation of accounting duties could adversely affect the City's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements.

CITY'S RESPONSE:

Management agrees with the finding and will look for opportunities to further segregate accounting duties.

Audit Finding 2016-001 -Material Audit Adjustment

During the year ended December 31, 2017, a prior period adjustment of \$35,795 and a material audit adjustment of \$41,927 were required to account for unearned revenues related to campsite fees for the years ending December 31, 2016 and December 31, 2017, respectively. In addition, a material audit adjustment in the amount of \$41,060 was required to account for retainage payable that was overstated.

CITY'S RESPONSE:

Management agrees with the finding and will continue to ensure that the financial statements are free from material misstatement.



Report on Legal Compliance

Independent Auditor's Report

Honorable Mayor and Members
of the City Council
City of Two Harbors
Two Harbors, Minnesota

We have audited, in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Two Harbors, Minnesota as of and for the year ended December 31, 2017, and the related notes to financial statements, which collectively comprise the City's basic financial statements, and have issued our report thereon dated April 16, 2018.

The *Minnesota Legal Compliance Audit Guide for Cities*, promulgated by the State Auditor pursuant to *Minnesota Statutes* § 6.65, contains seven categories of compliance to be tested: contracting and bidding, deposits and investments, conflicts of interest, public indebtedness, claims and disbursements, miscellaneous provisions, and tax increment financing. Our audit considered all of the listed categories.

In connection with our audit, nothing came to our attention that caused us to believe that the City of Two Harbors failed to comply with the provisions of the *Minnesota Legal Compliance Audit Guide for Cities*. However, our audit was not directed primarily toward obtaining knowledge of such noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding the City's noncompliance with the above referenced provisions.

The purpose of this report is solely to describe the scope of our testing of compliance and the results of that testing, and not to provide an opinion on compliance. Accordingly, this communication is not suitable for any other purpose.

BergankDV Ltd.

Minneapolis, Minnesota
April 16, 2018

FORM OF LEGAL OPINION

(See following page)

FRYBERGER

— LAW FIRM —

July 17, 2018

City of Two Harbors
522 1st Avenue
Two Harbors, MN 55616-1504

[PURCHASER]

**RE: City of Two Harbors, Minnesota
\$2,140,000 General Obligation Bonds, Series 2018A**

We have acted as Bond Counsel in connection with the authorization, issuance and delivery by the City of Two Harbors, Lake County, Minnesota (the “Issuer”), of the above-referenced bonds dated the date hereof (the “Bonds”). The Bonds are issued pursuant to Minnesota Statutes, Chapters 410/412, 429 and 475.

A. Scope of Examination. For the purpose of rendering this opinion letter, we have examined the following:

1. a resolution of the Issuer adopted on June 25, 2018 authorizing the issuance and delivery of the Bonds (the “Resolution”);
2. the Officers’ Certificate of the Issuer dated the date hereof setting forth and certifying as to certain matters, including but not limited to the use and investment of the proceeds of the Bonds (the “Tax Certificate”);
3. applicable law and certified copies of certain proceedings taken, and certain affidavits and certificates furnished by the Issuer and others with respect to the authorization, sale and issuance of the Bonds; and
4. such other documents as we consider necessary in order to render this opinion.

B. Reliance. As to questions of fact material to our opinion, we have relied upon certified proceedings, documents and certifications furnished to us by public officials and officers of the Issuer and others without undertaking to verify such facts by independent investigation. We have also relied, without independent investigation, upon representations and certifications made by the Issuer in the Tax Certificate and the representations and certifications made by the Issuer, agents of the Issuer and others in connection with the issuance of the Bonds as to: (a) the nature, cost, use and useful economic life of

FRYBERGER, BUCHANAN, SMITH & FREDERICK, P.A.

DULUTH
302 W. Superior Street, Ste. 700
Duluth, MN 55802
p: (218) 722-0861
f: (218) 725-6800

SUPERIOR
1409 Hammond Avenue, Ste. 330
Superior, WI 54880
p: (715) 392-7405
f: (715) 392-7407

ST. PAUL
380 St. Peter Street, Ste. 710
St. Paul, MN 55102
p: (651) 221-1044
f: (651) 221-1035

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the facilities and/or improvements financed by the Bonds, (b) the application to be made of the proceeds of the Bonds, (c) the investment of such proceeds and (d) other matters material to the tax-exempt status of the interest borne by the Bonds, including the anticipated sources of repayment of the Bonds.

C. Assumptions.

1. In rendering the opinions contained in Section D below, we have assumed: (a) the legal capacity for all purposes relevant hereto of all natural persons, (b) with respect to all parties to agreements or instruments relevant hereto other than the Issuer, that such parties had the requisite power and authority (corporate or otherwise) to execute, deliver and perform such agreements or instruments, (c) that such agreements or instruments are the valid, binding and enforceable obligations of each such party, other than the Issuer, (d) the authenticity of all documents submitted to us as originals and the authenticity of the originals, (e) the conformity to original documents of all documents submitted to us as certified or photostatic copies, (f) the genuineness of the signatures on all documents submitted to us, and (g) the accuracy of the facts and representations stated in all documents submitted to us.

2. In rendering the opinions contained in paragraphs 3 and 4 of Section D below, we have assumed that the proceeds of the Bonds will be applied in accordance with the provisions of the Resolution and the representations made by the Issuer in the Tax Certificate and that the Issuer will make or cause to be made any necessary calculations and pay to the United States any amounts required under Section 148 of the Internal Revenue Code of 1986, as amended (the "Code").

3. For the purpose of rendering the opinion set forth in paragraph 3 of Section D, below, we have also assumed compliance by the Issuer with requirements of the Code that must be satisfied subsequent to the issuance of the Bonds. The Issuer has covenanted to comply with each such requirement.

D. Opinions. Based upon such examination, assumptions and reliance, on the basis of federal and State of Minnesota (the "State") laws, regulations, rulings and decisions in effect on the date hereof, but excluding any pending legislation which may have a retroactive date prior to the date hereof, and subject to certain limitations set forth in Section E below, it is our opinion that:

1. The Bonds are valid and binding general obligations of the Issuer enforceable in accordance with their terms.

2. All taxable property in the territory of the Issuer is subject to ad valorem taxation without limitation as to rate or amount to pay the principal of and interest on the Bonds.

3. The Bonds, as of their date of issuance, bear interest which is not includable in gross income of the recipient for federal income tax purposes or in taxable net income of individuals, trusts and estates for State income tax purposes, but such interest is includable in

July 17, 2018

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taxable income of corporations and financial institutions for purposes of State franchise tax. Interest on the Bonds is not an item of tax preference which is included in alternative minimum taxable income for purposes of the federal alternative minimum tax imposed on individuals or the State alternative minimum tax imposed on individuals, trusts and estates.

4. Based solely on factual representations by the Issuer, the Bonds have been designated by the Issuer as “qualified tax-exempt obligations” under and within the meaning of Section 265(b)(3)(b) of the Code.

E. Qualifications and Limitations. The opinions expressed in Section D above are subject to the following:

1. We express no opinion as to federal or state tax consequences arising from ownership of the Bonds other than as set forth in Section D hereof.

2. The rights of the owners and enforceability of the Bonds are subject to and may be limited by (a) state and federal laws, rulings, decisions and principles of equity affecting remedies, including (without limitation) concepts of materiality, reasonableness, good faith and fair dealing, and other similar doctrines affecting the enforceability of agreements generally (regardless of whether considered in a proceeding in equity or at law); (b) the effect of any applicable bankruptcy, moratorium, insolvency, reorganization, fraudulent conveyance or other similar laws affecting the enforcement of creditors’ or secured creditors’ rights or laws relating to creditors’ or secured creditors’ rights against public instrumentalities heretofore or hereafter enacted to the extent constitutionally applicable; (c) the exercise of judicial discretion in appropriate cases; and (d) federal and state securities laws and public policy relating thereto.

3. Failure by the Issuer to comply with applicable requirements of the Code could cause the interest on the Bonds to be includable in the gross income of the owners thereof for federal income taxation, either prospectively or retroactively to the date hereof.

4. Our opinions expressed in Section D above are limited to the law of the State and the federal law of the United States of America, and we assume no responsibility as to the applicability to this transaction, or the effect thereon, of the law of any other jurisdiction.

5. Except as expressly stated in this opinion, we express no opinion as to compliance with any federal securities laws or any state securities or Blue Sky laws.

6. This opinion is rendered as of the date set forth above and we express no opinion as to circumstances or events which may occur subsequent to such date.

7. The foregoing opinions are being furnished to you solely for your benefit and may not be relied upon by, nor may copies be delivered to, any other person without our prior written consent.

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8. We have not been engaged or undertaken to review the accuracy, completeness or sufficiency of any offering material relating to the Bonds, and we express no opinion relating thereto.

Respectfully submitted,

Fryberger, Buchanan, Smith & Frederick, P.A.

BOOK-ENTRY-ONLY SYSTEM

1. The Depository Trust Company ("DTC"), New York, New York, will act as securities depository for the securities (the "Securities"). The Securities will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Security certificate will be issued for [each issue of] the Securities, [each] in the aggregate principal amount of such issue, and will be deposited with DTC. [If, however, the aggregate principal amount of [any] issue exceeds \$500 million, one certificate will be issued with respect to each \$500 million of principal amount, and an additional certificate will be issued with respect to any remaining principal amount of such issue.]
2. DTC, the world's largest securities depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments (from over 100 countries) that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has a Standard & Poor's rating of AA+. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com.
3. Purchases of Securities under the DTC system must be made by or through Direct Participants, which will receive a credit for the Securities on DTC's records. The ownership interest of each actual purchaser of each Security ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Securities are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Securities, except in the event that use of the book-entry system for the Securities is discontinued.
4. To facilitate subsequent transfers, all Securities deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Securities with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Securities; DTC's records reflect only the identity of the Direct Participants to whose accounts such Securities are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

5. Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. [Beneficial Owners of Securities may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Securities, such as redemptions, tenders, defaults, and proposed amendments to the Security documents. For example, Beneficial Owners of Securities may wish to ascertain that the nominee holding the Securities for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of notices be provided directly to them.]
6. Redemption notices shall be sent to DTC. If less than all of the Securities within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.
7. Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to Securities unless authorized by a Direct Participant in accordance with DTC's MMI Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to City as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts Securities are credited on the record date (identified in a listing attached to the Omnibus Proxy).
8. Redemption proceeds, distributions, and dividend payments on the Securities will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the City or Agent, on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC, Agent, or the City, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, distributions, and dividend payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the City or Agent, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.
9. A Beneficial Owner shall give notice to elect to have its Securities purchased or tendered, through its Participant, to [Tender/Remarketing] Agent, and shall effect delivery of such Securities by causing the Direct Participant to transfer the Participant's interest in the Securities, on DTC's records, to [Tender/Remarketing] Agent. The requirement for physical delivery of Securities in connection with an optional tender or a mandatory purchase will be deemed satisfied when the ownership rights in the Securities are transferred by Direct Participants on DTC's records and followed by a book-entry credit of tendered Securities to [Tender/Remarketing] Agent's DTC account.
10. DTC may discontinue providing its services as depository with respect to the Securities at any time by giving reasonable notice to the City or Agent. Under such circumstances, in the event that a successor depository is not obtained, Security certificates are required to be printed and delivered.
11. The City may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In that event, Security certificates will be printed and delivered to DTC.
12. The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that the City believes to be reliable, but the City takes no responsibility for the accuracy thereof.

APPENDIX D

FORM OF CONTINUING DISCLOSURE CERTIFICATE

(See following page)

LIMITED CONTINUING DISCLOSURE CERTIFICATE

This Limited Continuing Disclosure Certificate (the “Disclosure Certificate”) is executed and delivered by the City of Two Harbors, Minnesota (the “Issuer”) in connection with the issuance of the \$2,140,000 General Obligation Bonds, Series 2018A, dated July 17, 2018 (the “Obligations”). The Obligations are being issued pursuant to a Resolution of the Issuer dated June 25, 2018 (the “Resolution”). The Issuer certifies (i) that it is the only obligated person with respect to the Obligations; and (ii) that on the date hereof, the Issuer is an obligated person with respect to less than \$10,000,000 aggregate amount of outstanding municipal securities, including the Obligations, and thus limited continuing disclosure pursuant to subparagraph (d)(2) of the Rule is required. The Issuer covenants and agrees as follows:

Section 1. (a) Purpose of the Disclosure Certificate. This Disclosure Certificate is being executed and delivered by the Issuer for the benefit of the holders and beneficial owners of the Obligations and in order to assist the Participating Underwriter in complying with the Rule (defined below). References in this Disclosure Certificate to holders of the Obligations shall include the beneficial owners of the Obligations. This Disclosure Certificate constitutes the written understanding under the Rule.

(b) Filing Requirements. Any filing under this Disclosure Certificate must be made solely by transmitting such filing to the MSRB (defined herein) through the Electronic Municipal Market Access (“EMMA”) System at www.emma.msrb.org in the format prescribed by the MSRB. All documents provided to the MSRB shall be accompanied by the identifying information prescribed by the MSRB.

Section 2. Definitions. In addition to the definitions set forth in the Resolution, which apply to any capitalized term used in this Disclosure Certificate unless otherwise defined in this Section, the following capitalized terms shall have the following meanings:

“Annual Report” means any Annual Report provided by the Issuer pursuant to, and as described in, Sections 3 and 4 of this Disclosure Certificate.

“Audited Financial Statements” means the Issuer’s annual financial statements, which are currently prepared in accordance with generally accepted accounting principles (GAAP) for governmental units as prescribed by the Governmental Accounting Standards Board (GASB) and which the Issuer intends to continue to prepare in substantially the same form.

“Dissemination Agent” means such person from time to time designated in writing by the Issuer and which has filed with the Issuer a written acceptance of such designation.

“IRS” means the Internal Revenue Service of the Department of the Treasury.

“Listed Events” means any of the events listed in Sections 5(a) and 5(b) of this Disclosure Certificate.

“MSRB” means the Municipal Securities Rulemaking Board, whose current address is 1300 I Street NW, Suite 1000, Washington, DC 20005.

“Official Statement” means the Official Statement, dated _____, delivered in connection with the original issuance and sale of the Obligations, together with any amendments thereto or supplements thereof.

“Participating Underwriter” means any of the original underwriter(s) of the Obligations required to comply with the Rule in connection with offering of the Obligations.

“Rule” means Rule 15c2-12(b)(5) adopted by the SEC under the Securities Exchange Act of 1934, as the same may be amended from time to time.

“SEC” means the Securities and Exchange Commission or any successor to its functions governing state and municipal securities.

Section 3. Provision of Annual Reports.

(a) The Issuer shall, or shall cause the Dissemination Agent to, not later than 12 months after the end of the fiscal year (presently December 31), commencing with the fiscal year ended December 31, 2018, provide to the MSRB, filed in accordance with Section 1(b) of this Disclosure Certificate, an Annual Report which is consistent with the requirements of Section 4 of this Disclosure Certificate.

(b) Not later than 15 days prior to the date specified in subsection (a) for providing the Annual Report to the MSRB, the Issuer shall provide the Annual Report to the Dissemination Agent (if the Issuer is not the Dissemination Agent).

(c) If the Issuer is unable or fails to provide an Annual Report by the date required in subsection (a), the Issuer shall send in a timely manner a notice of such fact to the MSRB in the format prescribed by the MSRB, as described in Section 1(b) of this Disclosure Certificate.

Section 4. Content of Annual Reports. The Issuer’s financial information or operating data shall contain or consist of the audited financial statements of the Issuer for the prior fiscal year, prepared in accordance with generally accepted accounting principles as promulgated from time to time by the Governmental Accounting Standards Board.

Section 5. Reporting of Significant Events.

(a) The Issuer shall give, or cause to be given notice of the occurrence of any of the following events with respect to the Obligations, in a timely manner not in excess of ten business days after the occurrence of the event:

- (1) principal and interest payment delinquencies;

- (2) unscheduled draws on debt service reserves reflecting financial difficulties;
- (3) unscheduled draws on credit enhancements reflecting financial difficulties;
- (4) substitution of credit or liquidity providers, if any, or their failure to perform;
- (5) adverse tax opinions or the issuance by the IRS of proposed or final determinations of taxability or of a Notice of Proposed Issue (IRS Form 5701-TEB);
- (6) tender offers;
- (7) defeasances;
- (8) rating changes; or
- (9) bankruptcy, insolvency, receivership or similar event of the Issuer.

(b) The Issuer shall give, or cause to be given, notice of the occurrence of any of the following events with respect to the Obligations, *if material*, in a timely manner not in excess of ten business days after the occurrence of the event:

- (1) non-payment related defaults;
- (2) unless described in (a)(5) above, other notices or determinations by the IRS with respect to the tax-exempt status of the Obligations, or other events affecting the tax-exempt status of the Obligations;
- (3) modifications to rights of holders of the Obligations;
- (4) bond calls;
- (5) release, substitution or sale of property securing repayment of the Obligations;
- (6) the consummation of a merger, consolidation or acquisition involving the Issuer or the sale of all or substantially all of the assets of the Issuer, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms; or
- (7) appointment of a successor or additional trustee or the change of name of a trustee.

(c) For the purposes of the event identified in subsection (a)(9), the event is considered to occur when any of the following occur: the appointment of a receiver,

fiscal agent or similar officer for the Issuer in a proceeding under the U.S. Bankruptcy Code or in any other proceeding under state or federal law in which a court or governmental authority has assumed jurisdiction over substantially all of the assets or business of the Issuer, or if such jurisdiction has been assumed by leaving the existing governing body and officials or officers in possession but subject to the supervision and orders of a court or governmental authority, or the entry of an order confirming a plan or reorganization, arrangement or liquidation by a court or governmental authority having supervision or jurisdiction over substantially all of the assets or business of the Issuer.

(d) Whenever the Issuer obtains knowledge of the occurrence of a Listed Event under subsection (b), the Issuer shall as soon as possible determine if such event would constitute material information for holders of Obligations.

(e) Unless otherwise required by law, the Issuer shall submit the information in the format prescribed by the MSRB, as described in Section 1(b) of this Disclosure Certificate.

Section 6. Termination of Reporting Obligation. The Issuer's obligations under this Disclosure Certificate shall terminate upon the legal defeasance, prior redemption or payment in full of all of the Obligations.

Section 7. Dissemination Agent. The Issuer may, from time to time, appoint or engage a Dissemination Agent to assist it in carrying out its obligations under this Disclosure Certificate, and may discharge any such Dissemination Agent, with or without appointing a successor Dissemination Agent. The Dissemination Agent shall not be responsible in any manner for the content of any notice or report prepared by the Issuer pursuant to this Disclosure Certificate. If at any time there is not any other designated Dissemination Agent, the Issuer shall be the Dissemination Agent.

Section 8. Amendment; Waiver. Notwithstanding any other provision of this Disclosure Certificate, the Issuer may amend this Disclosure Certificate and any provision of this Disclosure Certificate may be waived if such amendment or waiver is supported by an opinion of nationally recognized bond counsel to the effect that such amendment or waiver would not, in and of itself, cause the undertaking herein to violate the Rule if such amendment or waiver had been effective on the date hereof but taking into account any subsequent change in or official interpretation of the Rule.

Section 9. Additional Information. Nothing in this Disclosure Certificate shall be deemed to prevent the Issuer from disseminating any other information, using the means of dissemination set forth in this Disclosure Certificate or any other means of communication, or including any other information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is required by this Disclosure Certificate. If the Issuer chooses to include any information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is specifically required by this Disclosure Certificate, the Issuer shall have no obligation under this Certificate to update such information or include it in any future Annual Report or notice of occurrence of a Listed Event.

Section 10. Default. In the event of a failure of the Issuer to comply with any provision of this Disclosure Certificate, any holder or beneficial owner of the Obligations may take such action as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the Issuer to comply with its obligations under this Disclosure Certificate. A default under this Disclosure Certificate shall not be deemed an event of default under the Resolution, and the sole remedy under this Disclosure Certificate in the event of any failure of the Issuer to comply with this Disclosure Certificate shall be an action to compel performance.

Section 11. Duties, Immunities and Liabilities of Dissemination Agent. The Dissemination Agent shall have only such duties as are specifically set forth in this Disclosure Certificate, and the Issuer agrees to indemnify and save the Dissemination Agent, its officers, directors, employees and agents, harmless against any loss, expense and liabilities which it may incur arising out of or in the exercise or performance of its powers and duties hereunder, including the costs and expenses (including attorneys fees) of defending against any claim of liability, but excluding liabilities due to the Dissemination Agent's negligence or willful misconduct. The obligations of the Issuer under this Section shall survive resignation or removal of the Dissemination Agent and payment of the Obligations.

Section 12. Beneficiaries. This Disclosure Certificate shall inure solely to the benefit of the Issuer, the Dissemination Agent, the Participating Underwriter and holders and beneficial owners from time to time of the Obligations, and shall create no rights in any other person or entity.

Section 13. Reserved Rights. The Issuer reserves the right to discontinue providing any information required under the Rule if a final determination should be made by a court of competent jurisdiction that the Rule is invalid or otherwise unlawful or, subject to the provisions of Section 8 hereof, to modify the undertaking under this Disclosure Certificate if the Issuer determines that such modification is required by the Rule or by a court of competent jurisdiction.

Dated as of July 17, 2018.

CITY OF TWO HARBORS, MINNESOTA

By _____
Mayor

By _____
Clerk

APPENDIX E

TERMS OF PROPOSAL

**\$2,140,000* GENERAL OBLIGATION BONDS, SERIES 2018A
CITY OF TWO HARBORS, MINNESOTA**

Proposals for the purchase of \$2,140,000* General Obligation Bonds, Series 2018A (the "Bonds") of the City of Two Harbors, Minnesota (the "City") will be received at the offices of Ehlers & Associates, Inc. ("Ehlers"), 3060 Centre Pointe Drive, Roseville, Minnesota 55113-1105, Municipal Advisors to the City, until 10:00 A.M., Central Time, and **ELECTRONIC PROPOSALS** will be received via **PARITY**, in the manner described below, until 10:00 A.M. Central Time, on June 25, 2018, at which time they will be opened, read and tabulated. The proposals will be presented to the City Council for consideration for award by resolution at a meeting to be held at 6:00 P.M., Central Time, on the same date. The proposal offering to purchase the Bonds upon the terms specified herein and most favorable to the City will be accepted unless all proposals are rejected.

PURPOSE

The Bonds are being issued pursuant to Minnesota Statutes, Chapters 429 and 475, and Sections 410.32, 412.301 and 475.58, by the City for the purpose of financing various public improvements, the acquisition of capital equipment, and to finance certain street reconstruction projects described in the City’s 5-Year Street Reconstruction Plan dated May 14, 2018. The Bonds will be general obligations of the City for which its full faith, credit and taxing powers are pledged.

DATES AND MATURITIES

The Bonds will be dated July 17, 2018, will be issued as fully registered Bonds in the denomination of \$5,000 each, or any integral multiple thereof, and will mature on February 1 as follows:

<u>Year</u>	<u>Amount*</u>	<u>Year</u>	<u>Amount*</u>	<u>Year</u>	<u>Amount*</u>
2020	\$120,000	2025	\$135,000	2030	\$150,000
2021	120,000	2026	140,000	2031	155,000
2022	125,000	2027	145,000	2032	165,000
2023	125,000	2028	140,000	2033	170,000
2024	130,000	2029	145,000	2034	175,000

ADJUSTMENT OPTION

* The City reserves the right to increase or decrease the principal amount of the Bonds on the day of sale, in increments of \$5,000 each. Increases or decreases may be made in any maturity. If any principal amounts are adjusted, the purchase price proposed will be adjusted to maintain the same gross spread per \$1,000.

TERM BOND OPTION

Proposals for the Bonds may contain a maturity schedule providing for any combination of serial bonds and term bonds, subject to mandatory redemption, so long as the amount of principal maturing or subject to mandatory redemption in each year conforms to the maturity schedule set forth above. All dates are inclusive.

INTEREST PAYMENT DATES AND RATES

Interest will be payable on February 1 and August 1 of each year, commencing February 1, 2019, to the registered owners of the Bonds appearing of record in the bond register as of the close of business on the 15th day (whether or not a business day) of the immediately preceding month. Interest will be computed upon the basis of a 360-day year of twelve 30-day months and will be rounded pursuant to rules of the Municipal Securities Rulemaking Board. **The rate for any maturity may not be more than 1.00% less than the rate for any preceding maturity. (For example, if a rate of 4.50% is proposed for the 2020 maturity, then the lowest rate that may be proposed for any later maturity is 3.50%.)** All Bonds of the same maturity must bear interest from date of issue until paid at a single, uniform rate. Each rate must be expressed in an integral multiple of 5/100 or 1/8 of 1%.

BOOK-ENTRY-ONLY FORMAT

Unless otherwise specified by the purchaser, the Bonds will be designated in the name of Cede & Co., as nominee for The Depository Trust Company, New York, New York ("DTC"). DTC will act as securities depository for the Bonds, and will be responsible for maintaining a book-entry system for recording the interests of its participants and the transfers of interests between its participants. The participants will be responsible for maintaining records regarding the beneficial interests of the individual purchasers of the Bonds. So long as Cede & Co. is the registered owner of the Bonds, all payments of principal and interest will be made to the depository which, in turn, will be obligated to remit such payments to its participants for subsequent disbursement to the beneficial owners of the Bonds.

PAYING AGENT

The City has selected Bond Trust Services Corporation, Roseville, Minnesota, to act as paying agent (the "Paying Agent"). Bond Trust Services Corporation and Ehlers are affiliate companies. The City will pay the charges for Paying Agent services. The City reserves the right to remove the Paying Agent and to appoint a successor.

OPTIONAL REDEMPTION

At the option of the City, the Bonds maturing on or after February 1, 2028 shall be subject to optional redemption prior to maturity on February 1, 2027 and on any date thereafter, at a price of par plus accrued interest.

Redemption may be in whole or in part of the Bonds subject to prepayment. If redemption is in part, the selection of the amounts and maturities of the Bonds to be redeemed shall be at the discretion of the City. If only part of the Bonds having a common maturity date are called for redemption, then the City or Paying Agent, if any, will notify DTC of the particular amount of such maturity to be redeemed. DTC will determine by lot the amount of each participant's interest in such maturity to be redeemed and each participant will then select by lot the beneficial ownership interest in such maturity to be redeemed.

Notice of redemption shall be sent by mail not more than 60 days and not less than 30 days prior to the date fixed for redemption to the registered owner of each Bond to be redeemed at the address shown on the registration books.

DELIVERY

On or about July 17, 2018, the Bonds will be delivered without cost to the winning bidder at DTC. On the day of closing, the City will furnish to the winning bidder the opinion of bond counsel hereinafter described, an arbitrage certification, and certificates verifying that no litigation in any manner questioning the validity of the Bonds is then pending or, to the best knowledge of officers of the City, threatened. Payment for the Bonds must be received by the City at its designated depository on the date of closing in immediately available funds.

LEGAL OPINION

An opinion as to the validity of the Bonds and the exemption from taxation of the interest thereon will be furnished by Fryberger, Buchanan, Smith & Frederick, P.A., Duluth, Minnesota, Bond Counsel to the City, and will be available at the time of delivery of the Bonds. The legal opinion will state that the Bonds are valid and binding general obligations of the City; provided that the rights of the owners of the Bonds and the enforceability of the Bonds may be limited by bankruptcy, insolvency, reorganization, moratorium, and other similar laws affecting creditors' rights and by equitable principles (which may be applied in either a legal or equitable proceeding). See "FORM OF LEGAL OPINION" found in Appendix B.

SUBMISSION OF PROPOSALS

Proposals must not be for less than \$2,114,320 plus accrued interest on the principal sum of \$2,140,000 from date of original issue of the Bonds to date of delivery. Prior to the time established above for the opening of proposals, interested parties may submit a proposal as follows:

- 1) Electronically to bondsale@ehlers-inc.com; or
- 2) Facsimile submission to Ehlers, Facsimile Number (651) 697-8555; or
- 3) Electronically via **PARITY** in accordance with this Terms of Proposal until 10:00 A.M. Central Time, but no proposal will be received after the time for receiving proposals specified above. To the extent any instructions or directions set forth in **PARITY** conflict with this Terms of Proposal, the terms of this Terms of Proposal shall control. For further information about **PARITY**, potential bidders may contact Ehlers or i-Deal LLC at 1359 Broadway, 2nd Floor, New York, New York 10018, Telephone (212) 849-5021.

Proposals must be submitted to Ehlers via one of the methods described above and must be received prior to the time established above for the opening of proposals. Each proposal must be unconditional except as to legality. Neither the City nor Ehlers shall be responsible for any failure to receive a facsimile submission.

A good faith deposit ("Deposit") in the amount of \$42,800 shall be made by the winning bidder by wire transfer of funds to **KleinBank, 1550 Audubon Road, Chaska, Minnesota, ABA No. 091915654 for credit: Ehlers & Associates Good Faith Account No. 3208138**. Such Deposit shall be received by Ehlers no later than two hours after the proposal opening time. The City reserves the right to award the Bonds to a winning bidder whose wire transfer is initiated but not received by such time provided that such winning bidder's federal wire reference number has been received by such time. In the event the Deposit is not received as provided above, the City may award the Bonds to the bidder submitting the next best proposal provided such bidder agrees to such award. The Deposit will be retained by the City as liquidated damages if the proposal is accepted and the Purchaser fails to comply therewith.

The City and the winning bidder who chooses to so wire the Deposit hereby agree irrevocably that Ehlers shall be the escrow holder of the Deposit wired to such account subject only to these conditions and duties: 1) All income earned thereon shall be retained by the escrow holder as payment for its expenses; 2) If the proposal is not accepted, Ehlers shall, at its expense, promptly return the Deposit amount to the winning bidder; 3) If the proposal is accepted, the Deposit shall be returned to the winning bidder at the closing; 4) Ehlers shall bear all costs of maintaining the escrow account and returning the funds to the winning bidder; 5) Ehlers shall not be an insurer of the Deposit amount and shall have no liability hereunder except if it willfully fails to perform or recklessly disregards, its duties specified herein; and 6) FDIC insurance on deposits within the escrow account shall be limited to \$250,000 per bidder.

No proposal can be withdrawn after the time set for receiving proposals unless the meeting of the City scheduled for award of the Bonds is adjourned, recessed, or continued to another date without award of the Bonds having been made.

AWARD

The Bonds will be awarded to the bidder offering the lowest interest rate to be determined on a True Interest Cost (TIC) basis. The City's computation of the interest rate of each proposal, in accordance with customary practice, will be controlling. In the event of a tie, the sale of the Bonds will be awarded by lot. The City reserves the right to reject any and all proposals and to waive any informality in any proposal.

BOND INSURANCE

If the Bonds are qualified for any bond insurance policy, the purchase of such policy shall be at the sole option and expense of the winning bidder. Any cost for such insurance policy is to be paid by the winning bidder, except that, if the City requested and received a rating on the Bonds from a rating agency, the City will pay that rating fee. Any rating agency fees not requested by the City are the responsibility of the winning bidder.

Failure of the municipal bond insurer to issue the policy after the Bonds are awarded to the winning bidder shall not constitute cause for failure or refusal by the winning bidder to accept delivery of the Bonds.

CUSIP NUMBERS

The City will assume no obligation for the assignment or printing of CUSIP numbers on the Bonds or for the correctness of any numbers printed thereon, but will permit such numbers to be printed at the expense of the winning bidder, if the winning bidder waives any delay in delivery occasioned thereby.

QUALIFIED TAX-EXEMPT OBLIGATIONS

The City will designate the Bonds as qualified tax-exempt obligations for purposes of Section 265(b)(3) of the Internal Revenue Code of 1986, as amended.

CONTINUING DISCLOSURE

In order to assist the Underwriters in complying with the provisions of Rule 15c2-12 promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934 the City will enter into an undertaking for the benefit of the holders of the Bonds. A description of the details and terms of the undertaking is set forth in Appendix D of the Preliminary Official Statement.

NEW ISSUE PRICING

The winning bidder will be required to provide, in a timely manner, certain information necessary to compute the yield on the Bonds pursuant to the provisions of the Internal Revenue Code of 1986, as amended, and to provide a certificate which will be provided by Bond Counsel upon request.

(a) The winning bidder shall assist the City in establishing the issue price of the Bonds and shall execute and deliver to the City at closing an "issue price" or similar certificate satisfactory to Bond Counsel setting forth the reasonably expected initial offering price to the public or the sales price or prices of the Bonds, together with the supporting pricing wires or equivalent communications. All actions to be taken by the City under this Terms of Proposal to establish the issue price of the Bonds may be taken on behalf of the City by the City's municipal advisor identified herein and any notice or report to be provided to the City may be provided to the City's municipal advisor.

(b) The City intends that the provisions of Treasury Regulation Section 1.148-1(f)(3)(i) (defining "competitive sale" for purposes of establishing the issue price of the Bonds) will apply to the initial sale of the Bonds (the "competitive sale requirements") because:

- (1) The City shall disseminate this Terms of Proposal to potential underwriters in a manner that is reasonably designed to reach potential investors;
- (2) all bidders shall have an equal opportunity to bid;
- (3) the City may receive proposals from at least three underwriters of municipal bonds who have established industry reputations for underwriting new issuances of municipal bonds; and
- (4) the City anticipates awarding the sale of the Bonds to the bidder who submits a firm offer to purchase the Bonds at the highest price (or lowest interest cost), as set forth in this Terms of Proposal.

Any proposal submitted pursuant to this Terms of Proposal shall be considered a firm offer for the purchase of the Bonds, as specified in this proposal.

(c) If all of the requirements of a "competitive sale" are not satisfied, the City shall advise the winning bidder of such fact prior to the time of award of the sale of the Bonds to the Underwriter. In such event, any proposal submitted will not be subject to cancellation or withdrawal and the City agrees to use the rule selected by the Underwriter on its proposal form to determine the issue price for the Bonds. On its proposal form, each Underwriter must select one of the following two rules for determining the issue price of the Bonds: (1) the first price at which 10% of a maturity of the Bonds (the "10% test") is sold to the public as the issue price of that maturity or (2) the initial offering price to the public as of the sale date as the issue price of each maturity of the Bonds (the "hold-the-offering-price rule").

(d) If all of the requirements of a "competitive sale" are not satisfied and the Underwriter selects the hold-the-offering-price rule, the winning bidder shall (i) confirm that the underwriters have offered or will offer the Bonds to the public on or before the date of award at the offering price or prices (the "initial offering price"), or at the corresponding yield or yields, set forth in the proposal submitted by the winning bidder and (ii) agree, on behalf of the underwriters participating in the purchase of the Bonds, that the underwriters will neither offer nor sell unsold Bonds of any maturity to which the hold-the-offering-price rule shall apply to any person at a price that is higher than the initial offering price to the public during the period starting on the sale date and ending on the earlier of the following:

- (1) the close of the fifth (5th) business day after the sale date; or
- (2) the date on which the underwriters have sold at least 10% of that maturity of the Bonds to the public at a price that is no higher than the initial offering price to the public.

The winning bidder shall promptly advise the City when the underwriters have sold 10% of that maturity of the Bonds to the public at a price that is no higher than the initial offering price to the public, if that occurs prior to the close of the fifth (5th) business day after the sale date.

The City acknowledges that in making the representation set forth above, the winning bidder will rely on (i) the agreement of each underwriter to comply with the hold-the-price rule, as set forth in an agreement among underwriters and the related pricing wires, (ii) in the event a selling group has been created in connection with the initial sale of the Bonds to the public, the agreement of each dealer who is a member of the selling group to comply with the hold-the-offering-price rule, as set forth in a selling group agreement and the related pricing wires, and (iii) in the event that an underwriter is a party to a retail distribution agreement that was employed in connection with the initial sale of the Bonds to the public, the agreement of each broker-dealer that is party to such agreement to comply with the hold-the-offering-price rule, as set forth in the retail distribution agreement and the related pricing wires. The City further acknowledges that each underwriter shall be solely liable for its failure to comply with its agreement regarding the hold-the-offering-price rule and that no underwriter shall be liable for the failure of any other underwriter, or of any dealer who is a member of a selling group, or of any broker-dealer that is a party to a retail distribution agreement to comply with its corresponding agreement regarding the hold-the-offering-price rule as applicable to the Bonds.

(e) If all of the requirements of a "competitive sale" are not satisfied and the Underwriter selects the 10% test, the Underwriter agrees to promptly report to the City, Bond Counsel and Ehlers the prices at which the Bonds have been sold to the public. That reporting obligation shall continue, whether or not the closing date has occurred, until the 10% test has been satisfied as to each maturity of the Bonds or until all of the Bonds of a certain maturity have been sold.

(f) By submitting a proposal, each bidder confirms that (i) any agreement among underwriters, any selling group agreement and each retail distribution agreement (to which the bidder is a party) relating to the initial sale of the Bonds to the public, together with the related pricing wires, contains or will contain language obligating each underwriter, each dealer who is a member of the selling group, and each broker-dealer that is party to such retail distribution agreement, as applicable, to (A) report the prices at which it sells to the public the unsold Bonds of each maturity allotted to it until it is notified by the winning bidder that either the 10% test has been satisfied as to the Bonds of that maturity or all Bonds of that maturity have been sold to the public, and (B) comply with the hold-the-offering-price rule, if applicable, in each case if and for so long as directed by the winning bidder and as set forth in the related pricing wires, and (ii) any agreement among underwriters relating to the initial sale of the Bonds to the public, together with the related pricing wires, contains or will contain language obligating each underwriter that is a party to a retail distribution agreement to be employed in connection with the initial sale of the Bonds to the public to require each broker-dealer that is a party to such retail distribution agreement to (A) report the prices at which it sells to the public the unsold Bonds of each maturity allotted to it until it is notified by the winning bidder or such underwriter that either the 10% test has been satisfied as to the Bonds of that maturity or all Bonds of that maturity have been sold to the public, and (B) comply with the hold-the-offering-price rule, if applicable, in each case if and for so long as directed by the winning bidder or such underwriter and as set forth in the related pricing wires.

(g) Sales of any Bonds to any person that is a related party to an underwriter shall not constitute sales to the public for purposes of this Terms of Proposal. Further, for purposes of this Terms of Proposal:

- (i) "public" means any person other than an underwriter or a related party,
- (ii) "underwriter" means (A) any person that agrees pursuant to a written contract with the City (or with the lead underwriter to form an underwriting syndicate) to participate in the initial sale of the Bonds to the public and (B) any person that agrees pursuant to a written contract directly or indirectly with a person described in clause (A) to participate in the initial sale of the Bonds to the public (including a member of a selling group or a party to a retail distribution agreement participating in the initial sale of the Bonds to the public),

- (iii) a purchaser of any of the Bonds is a "related party" to an underwriter if the underwriter and the purchaser are subject, directly or indirectly, to (i) at least 50% common ownership of the voting power or the total value of their stock, if both entities are corporations (including direct ownership by one corporation of another), (ii) more than 50% common ownership of their capital interests or profits interests, if both entities are partnerships (including direct ownership by one partnership of another), or (iii) more than 50% common ownership of the value of the outstanding stock of the corporation or the capital interests or profit interests of the partnership, as applicable, if one entity is a corporation and the other entity is a partnership (including direct ownership of the applicable stock or interests by one entity of the other), and
- (iv) "sale date" means the date that the Bonds are awarded by the City to the winning bidder.

PRELIMINARY OFFICIAL STATEMENT

Bidders may obtain a copy of the Preliminary Official Statement relating to the Bonds prior to the proposal opening by request from Ehlers at www.ehlers-inc.com by connecting to the Bond Sales link. The Syndicate Manager will be provided with an electronic copy of the Final Official Statement within seven business days of the proposal acceptance. Up to 10 printed copies of the Final Official Statement will be provided upon request. Additional copies of the Final Official Statement will be available at a cost of \$10.00 per copy.

Information for bidders and proposal forms may be obtained from Ehlers at 3060 Centre Pointe Drive, Roseville, Minnesota 55113-1105, Telephone (651) 697-8500.

By Order of the City Council

City of Two Harbors, Minnesota

PROPOSAL FORM

The City Council
City of Two Harbors, Minnesota

June 25, 2018

RE: **\$2,140,000* General Obligation Bonds, Series 2018A**
DATED: **July 17, 2018**

For all or none of the above Bonds, in accordance with the Terms of Proposal and terms of the Global Book-Entry System (unless otherwise specified by the Purchaser) as stated in this Official Statement, we will pay you \$ _____ (not less than \$2,114,320) plus accrued interest to date of delivery for fully registered Bonds bearing interest rates and maturing in the stated years as follows:

_____	% due	2020	_____	% due	2025	_____	% due	2030
_____	% due	2021	_____	% due	2026	_____	% due	2031
_____	% due	2022	_____	% due	2027	_____	% due	2032
_____	% due	2023	_____	% due	2028	_____	% due	2033
_____	% due	2024	_____	% due	2029	_____	% due	2034

* The City reserves the right to increase or decrease the principal amount of the Bonds on the day of sale, in increments of \$5,000 each. Increases or decreases may be made in any maturity. If any principal amounts are adjusted, the purchase price proposed will be adjusted to maintain the same gross spread per \$1,000.

The rate for any maturity may not be more than 1.00% less than the rate for any preceding maturity. (For example, if a rate of 4.50% is proposed for the 2020 maturity, then the lowest rate that may be proposed for any later maturity is 3.50%.) All Bonds of the same maturity must bear interest from date of issue until paid at a single, uniform rate. Each rate must be expressed in an integral multiple of 5/100 or 1/8 of 1%.

We enclose our Deposit in the amount of \$42,800, to be held by you pending delivery and payment. Alternatively, if we are the winning bidder, we will wire our Deposit to **KleinBank, 1550 Audubon Road, Chaska, Minnesota, ABA No. 091915654 for credit: Ehlers & Associates Good Faith Account No. 3208138**. Such Deposit shall be received by Ehlers & Associates no later than two hours after the proposal opening time. The City reserves the right to award the Bonds to a winning bidder whose wire transfer is initiated but not received by such time provided that such winning bidder's federal wire reference number has been received. In the event the Deposit is not received as provided above, the City may award the Bonds to the bidder submitting the next best proposal provided such bidder agrees to such award. If our proposal is not accepted, said deposit shall be promptly returned to us. If the Deposit is wired to such escrow account, we agree to the conditions and duties of Ehlers & Associates, Inc., as escrow holder of the Deposit, pursuant to the Terms of Proposal. This proposal is for prompt acceptance and is conditional upon delivery of said Bonds to The Depository Trust Company, New York, New York, in accordance with the Terms of Proposal. Delivery is anticipated to be on or about July 17, 2018.

This proposal is subject to the City's agreement to enter into a written undertaking to provide continuing disclosure under Rule 15c2-12 promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934 as described in the Preliminary Official Statement for this Issue.

We have received and reviewed the Official Statement and have submitted our requests for additional information or corrections to the Final Official Statement. As Syndicate Manager, we agree to provide the City with the reoffering price of the Bonds within 24 hours of the proposal acceptance.

This proposal is a firm offer for the purchase of the Bonds identified in the Terms of Proposal, on the terms set forth in this proposal form and the Terms of Proposal, and is not subject to any conditions, except as permitted by the Terms of Proposal.

By submitting this proposal, we confirm that we are an Underwriter and have an established industry reputation for underwriting new issuances of municipal bonds. YES: ____ NO: ____.

If the competitive sale requirements are not met, we elect to use the (circle one): 10% test / hold-the-offering-price rule to determine the issue price of the Bonds.

Account Manager: _____ By: _____
Account Members: _____

Award will be on a true interest cost basis. According to our computations (the correct computation being controlling in the award), the total dollar interest cost (including any discount or less any premium) computed from July 17, 2018 of the above proposal is \$ _____ and the true interest cost (TIC) is _____ %.

The foregoing offer is hereby accepted by and on behalf of the City Council of the City of Two Harbors, Minnesota, on June 25, 2018.

By: _____ By: _____
Title: _____ Title: _____