

PRELIMINARY OFFICIAL STATEMENT DATED JUNE 3, 2026

In the opinion of Fryberger, Buchanan, Smith & Frederick, P.A., Bond Counsel, based on present federal and Minnesota laws, regulations, rulings and decisions, and assuming compliance with certain requirements of the Internal Revenue Code of 1986, as amended (the "Code"), and certain covenants of the City, interest to be paid on the Bonds is excluded from gross income for federal income tax purposes and from taxable net income of individuals, estates and trusts for Minnesota income tax purposes, and 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 Minnesota alternative minimum tax imposed on individuals, trusts and estates; however, interest on the Bonds may affect the federal alternative minimum tax imposed on certain corporations. Such interest is includable in taxable income of corporations and financial institutions for purposes of the Minnesota franchise tax. (See "TAX EXEMPTION" herein.)

The Bonds will be designated 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. No opinion will be expressed regarding other state of federal tax consequences caused by the receipt of accrual of interest on or arising with respect to ownership of the Bonds..

New Issue

Credit Enhanced Rating: S&P Global Ratings "AAA"
Underlying Rating: S&P Global Ratings "AA-"/Stable

CITY OF TWO HARBORS, MINNESOTA (Lake County)

\$2,460,000* GENERAL OBLIGATION WATER AND SEWER REVENUE BONDS, SERIES 2026A

PROPOSAL OPENING: June 8, 2026, 10:00 A.M., C.T.

CONSIDERATION: June 8, 2026, 5:30 P.M., C.T.

PURPOSE/AUTHORITY/SECURITY: The \$2,460,000* General Obligation Water and Sewer Revenue Bonds, Series 2026A (the "Bonds"), are being issued pursuant to Minnesota Statutes, Chapters 444 and 475, as amended, by the City of Two Harbors, Minnesota (the "City"), for the purpose of financing the construction of various municipal water and sanitary sewer system improvements within the City. The Bonds will be general obligations of the City for which its full faith and 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: June 25, 2026

MATURITY: February 1 as follows:

<u>Year</u>	<u>Amount*</u>	<u>Year</u>	<u>Amount*</u>	<u>Year</u>	<u>Amount*</u>
2028	\$130,000	2033	\$150,000	2038	\$180,000
2029	135,000	2034	155,000	2039	185,000
2030	135,000	2035	160,000	2040	195,000
2031	140,000	2036	165,000	2041	200,000
2032	145,000	2037	175,000	2042	210,000

***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, 2027 and semiannually thereafter.

OPTIONAL REDEMPTION: Bonds maturing on February 1, 2037, and thereafter are subject to call for prior optional redemption on February 1, 2036, or any date thereafter, at a price of par plus accrued interest to the date of optional redemption.

MINIMUM PROPOSAL: \$2,430,480.

GOOD FAITH DEPOSIT: A good faith deposit in the amount of \$49,200 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.



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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 Underwriter (Syndicate Manager). 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 and 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 and Associates, Inc., payable entirely by the City, is contingent upon the delivery of the Bonds.

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 and 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 City is 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>
Lew Conner	Mayor	January 2027
Ben Redden	Vice President	January 2027
Catherine Erickson	Council Member	January 2029
Robin Glaser	Council Member	January 2029
Uriah Hefter	Council Member	January 2027
Donna Heil	Council Member	January 2027
Todd Redmann	Council Member	January 2029

ADMINISTRATION

Miranda Pietila, Finance Director
Patricia Nordean, City Administrator

PROFESSIONAL SERVICES

Costley & Morris, P.C., City Attorney, Two Harbors, Minnesota

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

Ehlers and Associates, Inc., Municipal Advisors, Minneapolis, Minnesota
(Other office located in Waukesha, Wisconsin)

INTRODUCTORY STATEMENT

This Preliminary Official Statement contains certain information regarding the City of Two Harbors, Minnesota (the "City") and the issuance of its \$2,460,000* General Obligation Water and Sewer Revenue Bonds, Series 2026A (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 issuance and sale of the Bonds ("Award Resolution") to be adopted by the City Council on June 8, 2026.

Inquiries may be directed to Ehlers and Associates, Inc. ("Ehlers" or the "Municipal Advisor"), Minneapolis, 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 Bond Sales link 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 June 25, 2026. 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, 2027, 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 2028 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, Minneapolis, Minnesota ("BTSC"), to act as paying agent (the "Paying Agent"). BTSC 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, 2037, shall be subject to optional redemption prior to maturity on February 1, 2036, or any date thereafter, at a price of par plus accrued interest to the date of optional redemption.

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 444 and 475, as amended, by the City, for the purpose of financing the construction of various municipal water and sanitary sewer system improvements within the City.

ESTIMATED SOURCES AND USES*

Sources		
Par Amount of Bonds	<u>\$2,460,000</u>	
Total Sources		\$2,460,000
Uses		
Total Underwriter's Discount (1.200%)	\$29,520	
Costs of Issuance	63,000	
Deposit to Construction Fund	2,362,848	
Rounding Amount	<u>4,632</u>	
Total Uses		\$2,460,000

*Preliminary, subject to change.

SECURITY

The Bonds will be general obligations of the City for which its full faith and credit and taxing powers are pledged without limitation as to rate or amount. The City anticipates that the debt service on the Bonds will be paid entirely from net revenues of the water and sanitary sewer systems ("utility revenues") which are owned and operated by the City. In accordance with Minnesota Statutes, receipt of utility revenues will be sufficient to provide not less than 105% of principal and interest on the Bonds.

RATING

The City will be participating in the State of Minnesota Credit Enhancement Program ("MNCEP") for this issue and requested a credit enhanced rating from S&P Global Ratings ("S&P"). S&P has a policy which assigns a rating of "AAA" to issuers participating in the MNCEP. The "AAA" rating is based on the State of Minnesota's current "AAA"/Stable outlook rating from S&P. See "STATE OF MINNESOTA CREDIT ENHANCEMENT PROGRAM" for further details.

The City received a "AA-"/Stable outlook underlying rating from S&P on this issue. Such rating reflects only the views of such organization and explanations of the significance of such rating may be obtained from the rating agency furnishing the same. 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.

STATE OF MINNESOTA CREDIT ENHANCEMENT PROGRAM

By resolution adopted for this issue on April 27, (the "Resolution"), the City has covenanted and obligated itself to be bound by the provisions of Minnesota Statutes, Section 446A.086 (the "Act"), which provides for payment by the State of Minnesota in the event of a potential default of certain obligations. The City has entered into a Credit Enhancement Program Agreement (the "Agreement") with the Minnesota Public Facilities Authority (the "Authority"), which is acting on behalf of the State of Minnesota. The provisions of the Agreement shall be binding on the City as long as any obligations of the issue remain outstanding.

The City covenants in the Agreement to deposit with the paying agent for the issue three business days prior to the date on which a payment is due an amount sufficient to make that payment. Under the Agreement, if the City believes it may be unable to make a principal or interest payment for this issue on the due date, it must notify the Authority not less than 15 business days prior to the date a payment is due on the Bonds if the City will be unable to make all or a portion of the payment. The City's agreement with the Paying Agent for the Bonds requires the Paying Agent to immediately inform the Minnesota Commissioner of Management and Budget, with a copy to the Authority, if the Paying Agent becomes aware of a default or potential default in the payment of principal or interest on the Bonds, or if, on the day two business days before the date a payment is due on the Bonds, there are insufficient funds on deposit with the Paying Agent to make the payment.

If the City is unable to make any portion of the payment on the Bonds on or before the date due, the State of Minnesota, acting through the Authority, shall make such payment in its place pursuant to the Act, providing that funds are available in the State General Fund. The obligation to make a payment under the Act is not a general obligation of the State of Minnesota. The Act does not obligate the Minnesota legislature to provide for the availability of funds in the General Fund for this purpose.

CONTINUING DISCLOSURE

In order to assist brokers, dealers, and municipal securities dealers, in connection with their participation in the offering of the Bonds, to comply with Rule 15c2-12 promulgated by the Securities and Exchange Commission, pursuant to the Securities and Exchange Act of 1934, as amended (the "Rule"), the City shall agree to provide certain information to the Municipal Securities Rulemaking Board ("MSRB") through its Electronic Municipal Market Access ("EMMA") system, or any system that may be prescribed in the future. The Rule was last amended, effective February 27, 2019, to include an expanded list of material events.

On the date of issue and delivery, the City shall execute and deliver a Continuing Disclosure Certificate, under which the City will covenant for the benefit of holders including beneficial holders, to provide electronically, or in a manner otherwise prescribed, certain financial information annually and to provide notices of the occurrence of certain events enumerated in the Rule (the "Disclosure Undertaking"). The details and terms of the Disclosure Undertaking for the City are set forth in Appendix D. Such Disclosure Undertaking will be in substantially the form attached hereto.

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

The City did not timely file the financial obligations incurred in September of 2022, December of 2022, and November of 2023. Except to the extent that the preceding is deemed to be material, the City believes it has not failed to comply in the previous five years in all material respects with its prior undertakings under the Rule. The City has reviewed its continuing disclosure responsibilities along with any changes to the Rule, to ensure compliance. Ehlers is currently engaged as dissemination agent for the City.

LEGAL MATTERS

Legal matters incident to the issuance and sale of the Bonds and with regard to the tax-exempt status of interest on the Bonds under existing laws are subject to the approving legal opinion of Fryberger, Buchanan, Smith & Frederick, P.A., as Bond Counsel to the City. Bond Counsel has not examined nor attempted to examine or verify any of the financial or statistical statements or data contained in the Official Statement and will express no opinions with respect to such information. Additionally, except for statements on the cover page of the Official Statement and under the caption "TAX EXEMPTION" relating to Bond Counsel's opinion that the interest on the Bonds is not includable in gross income for federal income tax purposes, Bond Counsel has not independently verified any of the factual information contained in the Official Statement nor have they conducted an investigation of the affairs of the City for the purpose of passing upon the accuracy or completeness of the Official Statement. No person is entitled to rely upon their limited participation as an assumption of responsibility for, or an expression of opinion of any kind with regard to, the accuracy or completeness of any of the information contained in the Official Statement. See "FORM OF LEGAL OPINION" found in Appendix B.

TAX EXEMPTION

The following discussion is not intended to be an exhaustive discussion of collateral tax consequences arising from ownership or disposition of the Bonds or receipt of interest on the Bonds. Prospective purchasers should consult their tax advisors with respect to collateral tax consequences, including without limitation, the determination of gain or loss on the sale of a bond, the calculation of alternative minimum tax liability; the inclusion of Social Security or other retirement payments in taxable income, the disallowance of deductions for certain expenses attributable to the Bonds, and applicable state and local tax rules in states other than Minnesota.

In the opinion of Fryberger, Buchanan, Smith & Frederick, P.A., Duluth, Minnesota, as Bond Counsel, based on present federal and Minnesota laws, regulations, rulings and decisions, and on certifications to be furnished at closing, and assuming compliance by the City with certain tax covenants, that interest to be paid on the Bonds is excluded from gross income for purposes of federal income taxation and from taxable net income of individuals, trusts and estates for purposes of Minnesota income taxation. Such interest is, however, included in taxable income of corporations and financial institutions for purposes of the Minnesota franchise tax; and 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 Minnesota alternative minimum tax imposed on individuals, trusts and estates; however, interest on the Bonds may affect the federal alternative minimum tax imposed on certain corporations.

Certain provisions of the Internal Revenue Code of 1986, as amended (the "Code"), however, impose continuing requirements that must be met after the issuance of the Bonds in order that interest on the Bonds be and remain excludable from federal gross income and from Minnesota taxable net income of individuals, estates, and trusts. These requirements include, but are not limited to, provisions regarding the use of bond proceeds and the facilities financed or refinanced with such proceeds; restrictions on the investment of bond proceeds and other amounts; and provisions requiring that certain investment earnings be rebated periodically to the federal government. Noncompliance with such requirements of the Code may cause interest on the Bonds to be includable in federal gross income or in Minnesota taxable net income retroactively to their date of issue. Compliance with the City's tax covenants will satisfy the current requirements of the Code with respect to exclusion of interest on the Bonds from federal gross income and from Minnesota taxable net income of individuals, estates and trusts. No provision has been made for redemption of or for an increase in the interest rate on the Bonds in the event that interest on the same becomes includable in federal gross income or in Minnesota taxable net income.

Bond Counsel has not undertaken to advise in the future whether any events after the date of issuance of the Bonds may affect the tax exempt status of interest on the Bonds or the tax consequences of ownership of the Bonds. No assurance can be given that future legislation, if enacted into law, will not contain provisions which could directly or indirectly affect the exclusion of the interest on the Bonds from gross income for federal income tax purposes.

Interest paid on tax-exempt obligations such as the Bonds is now generally required to be reported by payors to the Internal Revenue Service ("IRS") and to recipients in the same manner as interest on taxable obligations. In addition, such interest may be subject to "backup withholding" if the bond owner fails to provide the information required on IRS Form W-9, Request for Taxpayer Identification Number and Certification, or the IRS has identified the bond owner as being subject to backup withholding.

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. Ehlers makes no representation, warranty or guarantee regarding the accuracy or completeness of the information in this Preliminary Official Statement, and its assistance in preparing this Preliminary Official Statement should not be construed as a representation that it has independently verified such information.

MUNICIPAL ADVISOR AFFILIATED COMPANIES

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, Colorado, 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, 2025, have been audited by BerganKDV, 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

The 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 (utility revenues) 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 of Minnesota (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.

Taconite Tax Loss: The City, in common with other Iron Range Communities, receives grants and aids which are derived from special taconite taxes and which may be reduced in the event of production curtailment. Also, homeowners now receive substantial homestead credits from taxes derived from taconite sources which may be reduced with a cut in production. Reduction of grants, state aids and credits could increase the City's need for other local taxes.

Iron Mining Economy: The City is located on Minnesota's Iron Range, with an economy directly related to the mining industry, including processing and shipping of iron ore (pellets) for the nation's steel industry and for foreign shipments. Beginning in 1981, economic downturns reduced demand for steel and for taconite pellets, and some taconite plants curtailed operations and employment.

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.

Levy Limits: The State Legislature has periodically imposed limitations on the ability of municipalities to levy property taxes. 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 and Associates.

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.

Cybersecurity: The City is dependent on electronic information technology systems to deliver services. These systems may contain sensitive information or support critical operational functions which may have value for unauthorized purposes. As a result, the electronic systems and networks may be targets of cyberattack. There can be no assurance that the City will not experience an information technology breach or attack with financial consequences that could have a material adverse impact.

The foregoing is intended only as a summary of certain risk factors attendant to an investment in the Bonds. In order for potential investors to identify risk factors and make an informed investment decision, potential investors should be thoroughly familiar with this entire Preliminary Official Statement and the Appendices hereto.

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	2023/24	2024/25	2025/26
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 \$2,150,000 - 0.50% ² Over \$2,150,000 - 1.00% ²	First \$500,000 HGA - 1.00% Over \$500,000 HGA - 1.25% First \$3,500,000 - 0.50% ² Over \$3,500,000 - 1.00% ²	First \$500,000 HGA - 1.00% Over \$500,000 HGA - 1.25% First \$3,500,000 - 0.50% ² Over \$3,500,000 - 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 \$174,000 - 0.75% Over \$174,000 - 0.25%	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: – 0.25%	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 – 0.25%
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

2025/26 Economic Market Value	<u>\$464,256,942¹</u>
2025/26 Assessor's Estimated Market Value	
Real Estate	\$437,752,200
Personal Property	<u>61,800</u>
Total Valuation	<u>\$437,814,000</u>
2025/26 Net Tax Capacity	
Real Estate	\$4,710,658
Personal Property	<u>1,236</u>
Net Tax Capacity	\$4,711,894
Less: Fiscal Disparities Contribution ²	<u>(339,711)</u>
Taxable Net Tax Capacity	\$4,372,183
Plus: Fiscal Disparities Distribution ²	<u>331,006</u>
Adjusted Taxable Net Tax Capacity	<u>\$4,703,189</u>

¹ According to the Minnesota Department of Revenue, the Assessor's Estimated Market Value (the "AEMV") for the City was about 94.39% of the actual selling prices of property 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 \$464,256,942.

² Each community in the taconite credit area contributes 40% of its new industrial and commercial valuation 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 losing net tax capacity for tax purposes. Taxes are spread on the basis of taxable net tax capacity.

2025/26 NET TAX CAPACITY BY CLASSIFICATION

	2025/26 Net Tax Capacity	Percent of Total Net Tax Capacity
Residential homestead	\$2,467,107	52.36%
Commercial/industrial	999,569	21.21%
Railroad operating property	163,148	3.46%
Non-homestead residential	994,004	21.10%
Commercial & residential seasonal/rec.	86,830	1.84%
Personal property	<u>1,236</u>	<u>0.03%</u>
 Total	 <u><u>\$4,711,894</u></u>	 <u><u>100.00%</u></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 Increase/Decrease in Estimated Market Value
2021/22	\$291,418,600	\$263,588,788	\$2,713,475	\$3,069,226	1.33%
2022/23	369,323,600	345,629,426	3,692,707	3,966,647	26.73%
2023/24	410,483,200	388,149,862	4,129,520	4,446,146	11.14%
2024/25	417,277,800	385,464,784	4,081,231	4,408,948	1.66%
2025/26	437,814,000	406,165,163	4,711,894	4,703,189	4.92%

¹ Net Tax Capacity is before fiscal disparities adjustments.

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

LARGEST TAXPAYERS

Taxpayer	Type of Property	2025/26 Net Tax Capacity	Percent of City's Total Net Tax Capacity
Wisconsin Central	Railroad	\$177,254	3.76%
402 13 th Ave, LLC	Apartment	77,139	1.64%
Miners Incorporated	Commercial	65,320	1.39%
2H Living Inc.	Apartment	60,845	1.29%
Lake View Mem Hos	Commercial	51,370	1.09%
Seagren Properties	Commercial	44,404	0.94%
Northshore Manufacturing	Industrial/Commercial	40,932	0.87%
Kwik Trip Inc.	Commercial	36,514	0.77%
Desanto Investments	Commercial	35,380	0.75%
Two Harbors Lodge	Commercial	32,274	0.68%
Total		\$621,432	13.19%

City's Total 2025/26 Net Tax Capacity \$4,711,894

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

DEBT

DIRECT DEBT¹

General Obligation Debt (see schedules following)

Total G.O. debt secured by special assessments and taxes	\$8,235,000
Total G.O. debt secured by taxes	1,780,000
Total G.O. debt secured by utility revenues (includes the Bonds)*	24,396,000
Total General Obligation Debt*	<u>\$34,411,000</u>

*Preliminary, subject to change.

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

Other Debt

Issue Date	Original Amount	Purpose	Final Maturity	Principal Outstanding
12/01/22	\$196,330	Golf Equipment Lease	12/01/27	<u>\$78,532</u>

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.

DEBT LIMIT

The statutory limit on net 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" means the amount remaining after deducting from gross debt the amount of current revenues which are applicable within the current fiscal year to the payment of any debt and the aggregate principal of certain obligations enumerated under Minnesota Statutes, Section 475.51, subd.4, including the following: (1) obligations issued for improvements payable wholly or partly from special assessments levied against benefitted property; (2) warrants or orders having no definite or fixed maturity; (3) obligations payable wholly from the income of revenue producing conveniences (includes the Bonds); (4) obligations issued to create or maintain a permanent improvement revolving fund; (5) obligations issued to finance any revenue producing public convenience; (6) funds held as sinking funds for payment of principal and interest on debt other than those deductible under Minnesota Statutes, Section 475.51, subd. 4; (7) obligations to repay energy conservation investment loans under Minnesota Statutes, Section 216C.37; (8) obligations issued to pay certain postemployment benefit liabilities; (9) obligations issued to pay certain judgments against the City; and (10) all 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.

2025/26 Assessor's Estimated Market Value	\$437,814,000
Multiply by 3%	<u>0.03</u>
Statutory Debt Limit	\$13,134,420
Less: Long-Term Debt Outstanding Being Paid Solely from Taxes	<u>(1,780,000)</u>
Unused Debt Limit	<u>\$11,354,420</u>

City of Two Harbors, Minnesota
Schedule of Bonded Indebtedness
General Obligation Debt Secured by Special Assessments and Taxes
(As of 06/25/2026)

	Improvement Bonds 1) Series 2018A		Improvement Bonds 2) Series 2019B		Improvement Bonds Series 2021A		Improvement Bonds Series 2024A							
Dated	07/17/2018		07/24/2019		07/01/2021		05/30/2024							
Amount	\$1,960,000		\$1,110,000		\$2,775,000		\$4,185,000							
Maturity	02/01		02/01		02/01		02/01							
Calendar Year Ending	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Total Principal	Total Interest	Total P & I	Principal Outstanding	% Paid	Calendar Year Ending
2026	0	18,716	0	14,475	0	15,800	0	94,325	0	143,316	143,316	8,235,000	.00%	2026
2027	130,000	34,831	25,000	28,575	180,000	29,800	205,000	183,525	540,000	276,731	816,731	7,695,000	6.56%	2027
2028	135,000	30,206	25,000	27,825	180,000	26,200	215,000	173,025	555,000	257,256	812,256	7,140,000	13.30%	2028
2029	140,000	26,081	30,000	27,000	185,000	22,550	225,000	162,025	580,000	237,656	817,656	6,560,000	20.34%	2029
2030	140,000	21,881	135,000	24,525	190,000	18,800	235,000	150,525	700,000	215,731	915,731	5,860,000	28.84%	2030
2031	145,000	17,516	140,000	20,400	190,000	15,950	250,000	138,400	725,000	192,266	917,266	5,135,000	37.64%	2031
2032	150,000	12,906	145,000	16,125	195,000	13,976	260,000	125,650	750,000	168,658	918,658	4,385,000	46.75%	2032
2033	160,000	7,963	150,000	11,700	195,000	11,831	275,000	112,275	780,000	143,769	923,769	3,605,000	56.22%	2033
2034	165,000	2,681	155,000	7,125	195,000	9,491	285,000	98,275	800,000	117,573	917,573	2,805,000	65.94%	2034
2035			160,000	2,400	200,000	6,973	300,000	83,650	660,000	93,023	753,023	2,145,000	73.95%	2035
2036					200,000	4,323	320,000	68,150	520,000	72,473	592,473	1,625,000	80.27%	2036
2037					205,000	1,486	335,000	51,775	540,000	53,261	593,261	1,085,000	86.82%	2037
2038							350,000	36,400	350,000	36,400	386,400	735,000	91.07%	2038
2039							360,000	22,200	360,000	22,200	382,200	375,000	95.45%	2039
2040							375,000	7,500	375,000	7,500	382,500	0	100.00%	2040
	1,165,000	172,781	965,000	180,150	2,115,000	177,180	3,990,000	1,507,700	8,235,000	2,037,811	10,272,811			

1) This represents the \$1,960,000 Improvement portion of the \$2,090,000 General Obligation Bonds, Series 2018A.

2) This represents the \$1,110,000 Improvement portion of the \$1,925,000 General Obligation Bonds, Series 2019B.

City of Two Harbors, Minnesota
Schedule of Bonded Indebtedness
General Obligation Debt Secured by Taxes
(As of 06/25/2026)

	Equipment Certs & Street Recon. Bonds 1) Series 2018A		Equipment Certificates 2) Series 2019B		Equipment Certificates Series 2021B		Equipment Certificates Series 2024B								Calendar Year Ending
Dated Amount	07/17/2018 \$130,000		07/24/2019 \$815,000		07/01/2021 \$715,000		05/30/2024 \$1,265,000								
Maturity	02/01		02/01		02/01		02/01								
Calendar Year Ending	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Total Principal	Total Interest	Total P & I	Principal Outstanding	% Paid	Calendar Year Ending	
2026	0	984	0	4,425	0	1,969	0	24,800	0	32,178	32,178	1,780,000	.00%	2026	
2027	10,000	1,769	95,000	7,425	105,000	3,281	165,000	45,475	375,000	57,950	432,950	1,405,000	21.07%	2027	
2028	5,000	1,494	100,000	4,500	105,000	1,969	175,000	36,975	385,000	44,938	429,938	1,020,000	42.70%	2028	
2029	5,000	1,344	100,000	1,500	105,000	656	180,000	28,100	390,000	31,600	421,600	630,000	64.61%	2029	
2030	5,000	1,194					190,000	19,800	195,000	20,994	215,994	435,000	75.56%	2030	
2031	5,000	1,041					195,000	12,100	200,000	13,141	213,141	235,000	86.80%	2031	
2032	10,000	806					205,000	4,100	215,000	4,906	219,906	20,000	98.88%	2032	
2033	10,000	488							10,000	488	10,488	10,000	99.44%	2033	
2034	10,000	163							10,000	163	10,163	0	100.00%	2034	
	60,000	9,281	295,000	17,850	315,000	7,875	1,110,000	171,350	1,780,000	206,356	1,986,356				

1) This represents the \$130,000 Equipment Certificates and Street Reconstruction portions of the \$2,090,000 General Obligation Bonds, Series 2018A.

2) This represents the \$815,000 Equipment Certificates portion of the \$1,925,000 General Obligation Bonds, Series 2019B.

City of Two Harbors, Minnesota
 Schedule of Bonded Indebtedness
 General Obligation Debt Secured by Utility Revenues
 (As of 06/25/2026)

	Revenue Note Series 2009		Revenue Note Series 2010		Revenue Note Series 2014		Revenue Note Series 2015		Revenue Note 1) Series 2018A	
Dated	12/21/2009		05/11/2010		10/13/2014		08/06/2015		10/10/2018	
Amount	\$2,175,783		\$2,262,255		\$106,572		\$4,741,091		\$1,825,939	
Maturity	08/20		08/20		08/20		08/20		08/20	
Calendar Year Ending	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
2026	128,000	6,712	130,000	4,429	7,600	155	242,000	12,650	93,000	6,395
2027	131,000	10,188	132,000	6,693	7,700	234	244,000	22,880	94,000	11,860
2028	134,000	6,876	134,000	4,496	7,800	157	247,000	20,440	95,000	10,920
2029	138,000	3,489	136,000	2,264	7,900	79	249,000	17,970	95,000	9,970
2030							252,000	15,480	96,000	9,020
2031							254,000	12,960	97,000	8,060
2032							257,000	10,420	98,000	7,090
2033							259,000	7,850	99,000	6,110
2034							262,000	5,260	100,000	5,120
2035							264,000	2,640	101,000	4,120
2036									103,000	3,110
2037									104,000	2,080
2038									104,000	1,040
2039										
2040										
2041										
2042										
2043										
2044										
2045										
2046										
2047										
2048										
2049										
2050										
2051										
	531,000	27,264	532,000	17,882	31,000	625	2,530,000	128,550	1,279,000	84,895

1) This reflects the final maturity schedule of the 2018 Clean Water Loan, originally dated October 10, 2018, which was amended on April 9, 2019.

--Continued on next page

City of Two Harbors, Minnesota
Schedule of Bonded Indebtedness continued
General Obligation Debt Secured by Utility Revenues
(As of 06/25/2026)

	Revenue Note Series 2022		Revenue Note Series 2023A		Water and Sewer Revenue Bonds Series 2026A							
Dated	09/19/2022		11/30/2023		06/25/2026							
Amount	\$14,493,919		\$3,742,361		\$2,460,000*							
Maturity	08/20		08/20		02/01							
Calendar Year Ending	Principal	Interest	Principal	Interest	Principal	Estimated Interest	Total Principal	Total Interest	Total P & I	Principal Outstanding	% Paid	Calendar Year Ending
2026	424,000	106,610	152,000	51,143	0	0	1,176,600	188,093	1,364,693	23,219,400	4.82%	2026
2027	431,000	206,529	156,000	97,869	0	103,585	1,195,700	459,838	1,655,538	22,023,700	9.72%	2027
2028	438,000	199,727	161,000	93,338	130,000	88,938	1,346,800	424,891	1,771,691	20,676,900	15.24%	2028
2029	445,000	192,816	165,000	88,661	135,000	84,830	1,370,900	400,078	1,770,978	19,306,000	20.86%	2029
2030	452,000	185,794	170,000	83,867	135,000	80,611	1,105,000	374,772	1,479,772	18,201,000	25.39%	2030
2031	459,000	178,661	175,000	78,929	140,000	76,210	1,125,000	354,820	1,479,820	17,076,000	30.00%	2031
2032	466,000	171,418	180,000	73,845	145,000	71,506	1,146,000	334,279	1,480,279	15,930,000	34.70%	2032
2033	474,000	164,065	185,000	68,616	150,000	66,528	1,167,000	313,168	1,480,168	14,763,000	39.49%	2033
2034	481,000	156,585	191,000	63,242	155,000	61,304	1,189,000	291,511	1,480,511	13,574,000	44.36%	2034
2035	489,000	148,995	196,000	57,693	160,000	55,790	1,210,000	269,238	1,479,238	12,364,000	49.32%	2035
2036	496,000	141,278	202,000	52,000	165,000	49,939	966,000	246,327	1,212,327	11,398,000	53.28%	2036
2037	504,000	133,451	208,000	46,131	175,000	43,646	991,000	225,309	1,216,309	10,407,000	57.34%	2037
2038	512,000	125,498	214,000	40,089	180,000	36,900	1,010,000	203,527	1,213,527	9,397,000	61.48%	2038
2039	520,000	117,419	220,000	33,872	185,000	29,781	925,000	181,073	1,106,073	8,472,000	65.27%	2039
2040	528,000	109,213	226,000	27,481	195,000	21,984	949,000	158,678	1,107,678	7,523,000	69.16%	2040
2041	537,000	100,882	233,000	20,916	200,000	13,540	970,000	135,338	1,105,338	6,553,000	73.14%	2041
2042	545,000	92,408	240,000	14,147	210,000	4,620	995,000	111,175	1,106,175	5,558,000	77.22%	2042
2043	554,000	83,808	247,000	7,175			801,000	90,983	891,983	4,757,000	80.50%	2043
2044	563,000	75,065					563,000	75,065	638,065	4,194,000	82.81%	2044
2045	571,000	66,181					571,000	66,181	637,181	3,623,000	85.15%	2045
2046	580,000	57,171					580,000	57,171	637,171	3,043,000	87.53%	2046
2047	590,000	48,019					590,000	48,019	638,019	2,453,000	89.95%	2047
2048	599,000	38,708					599,000	38,708	637,708	1,854,000	92.40%	2048
2049	608,000	29,256					608,000	29,256	637,256	1,246,000	94.89%	2049
2050	618,000	19,662					618,000	19,662	637,662	628,000	97.43%	2050
2051	628,000	9,910					628,000	9,910	637,910	0	100.00%	2051
	13,512,000	2,959,129	3,521,000	999,015	2,460,000	889,711	24,396,000	5,107,071	29,503,071			

* Preliminary, subject to change.

OVERLAPPING DEBT¹

Taxing District	2025/26 Adjusted Taxable Net Tax Capacity	% In City	Total G.O. Debt²	City's Proportionate Share
Lake County	\$35,124,600	12.4476%	\$7,155,000	\$890,626
I.S.D. No. 381 (Lake Superior Public Schools)	42,120,314	10.3802%	38,440,000 ³	<u>3,990,149</u>
City's Share of Total Overlapping Debt				<u><u>\$4,880,775</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. It 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 Minnesota School Districts may qualify for aid from the State of Minnesota through the Debt Service Equalization Formula, School Building Bond Agricultural Credit and Long Term Facilities Maintenance Revenue programs. While some of the districts listed may receive these aids, Ehlers has not attempted to estimate the portion of debt service payments that would be financed by State aids for the purposes of the Bonds.

DEBT RATIOS

	G.O. Debt	Debt/Economic Market Value \$464,256,942	Debt/ Per Capita 3,508 ¹
Direct G.O. Debt Secured By:			
Special Assessments & Taxes	\$8,235,000		
Taxes	1,780,000		
Utility Revenues*	24,396,000		
Total General Obligation Debt*	<u>\$34,411,000</u>		
Less: G.O. Debt Paid Entirely from Revenues ²	<u>(24,396,000)</u>		
Tax Supported General Obligation Debt*	\$10,015,000	2.16%	\$2,854.90
City's Share of Total Overlapping Debt	<u>\$4,880,775</u>	<u>1.05%</u>	<u>\$1,391.33</u>
Total*	<u><u>\$14,895,775</u></u>	<u><u>3.21%</u></u>	<u><u>\$4,246.23</u></u>

*Preliminary, subject to change.

TAX LEVIES, COLLECTIONS AND RATES

TAX LEVIES AND COLLECTIONS

Tax Year	Net Tax Levy ³	Total Collected Following Year	Collected to Date	% Collected
2021/22	\$2,241,707	\$2,198,533	\$2,238,430	99.85%
2022/23	2,301,064	2,263,227	2,292,724	99.64%
2023/24	2,348,918	2,294,606	2,329,226	99.16%
2024/25	2,291,869	2,242,246	2,242,248	97.83%
2025/26	2,406,662	In process of collection		

Property taxes are collected in two installments in Minnesota--the first by May 15 and the second by October 15.⁴ 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.

¹ Estimated 2024 population.

² Debt service on the City's general obligation revenue debt is being paid entirely from revenues and therefore is considered self-supporting debt.

³ This reflects the Final Levy Certification of the City after all adjustments have been made.

⁴ Second half tax payments on agricultural property are due on November 15 of each year.

TAX CAPACITY RATES¹

	2021/22	2022/23	2023/24	2024/25	2025/26
Lake County	53.903%	42.684%	38.224%	37.674%	37.109%
City of Two Harbors	81.394%	61.595%	56.445%	59.607%	57.630%
I.S.D. No. 381 (Lake Superior Public Schools)	14.240%	9.988%	8.802%	9.406%	8.452%
ARDC	0.170%	0.133%	0.128%	0.132%	0.124%
Lake County HRA	0.564%	0.869%	1.176%	1.795%	1.777%
Regional Rail Authority	0.859%	0.766%	0.756%	0.924%	0.949%

Referendum Market Value Rates:

I.S.D. No. 381 (Lake Superior Public Schools)	0.08200%	0.06139%	0.05615%	0.05271%	0.04859%
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Source: Tax Levies and Collections and Tax Capacity Rates have been furnished by Lake County.

THE ISSUER

CITY GOVERNMENT

The City 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/Clerk and Finance Director are responsible for administrative details and financial records.

EMPLOYEES; PENSIONS; UNIONS

The City currently has 49 full-time and 58 part-time 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.

¹ After reduction for State aids. Does not include the statewide general property tax against commercial/industrial, non-homestead resorts and seasonal recreational residential property.

Recognized and Certified Bargaining Units

Bargaining Unit	Expiration Date of Current Contract
AFSCME Local 1123	December 31, 2026
IBEW Local No. 31	December 31, 2026
Teamsters General Local Union No. 346	December 31, 2026
Supervisory Employees Association	December 31, 2026
Confidential Employees Association	December 31, 2026

POST EMPLOYMENT BENEFITS

The City has obligations for some post-employment benefits for its employees. Accounting for these obligations is dictated by Governmental Accounting Standards Board Statement No. 75 (GASB 75). The City's most recent Audited Financial Statements (Audit) shows a total OPEB liability of \$2,445,427, as of December 31, 2025. The City has been funding these obligations on a pay-as-you-go basis.

Source: The City's most recent Audit.

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, Section 471.831, as amended, 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 April 13, 2026)

Fund	Total Cash and Investments
General	\$3,364,054
Special Revenue	2,976,096
Debt Service	100,366
Capital Projects	1,633,475
Enterprise Funds	<u>18,569,268</u>
Total Funds on Hand	<u><u>\$26,643,259</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:

	2023 Audited	2024 Audited	2025 Audited
Water			
Total Operating Revenues	\$1,335,291	\$1,337,369	\$1,352,706
Less: Operating Expenses	<u>(1,053,553)</u>	<u>(1,305,603)</u>	<u>(1,584,515)</u>
Operating Income	\$281,738	\$31,766	(\$231,809)
Plus: Depreciation	<u>448,988</u>	<u>452,193</u>	<u>728,908</u>
Revenues Available for Debt Service	<u><u>\$730,726</u></u>	<u><u>\$483,959</u></u>	<u><u>\$497,099</u></u>
Sewer¹			
Total Operating Revenues	\$1,476,006	\$1,511,207	\$1,483,708
Less: Operating Expenses	<u>(1,694,104)</u>	<u>(1,901,227)</u>	<u>(2,868,043)</u>
Operating Income	(\$218,098)	(\$390,020)	(\$1,384,335)
Plus: Depreciation	<u>457,092</u>	<u>453,240</u>	<u>1,482,143</u>
Revenues Available for Debt Service	<u><u>\$238,994</u></u>	<u><u>\$63,220</u></u>	<u><u>\$97,808</u></u>
Electric			
Total Operating Revenues	\$2,067,801	\$2,172,843	\$1,853,624
Less: Operating Expenses	<u>(1,315,978)</u>	<u>(1,098,114)</u>	<u>(1,275,593)</u>
Operating Income	\$751,823	\$1,074,729	\$578,031
Plus: Depreciation	<u>187,219</u>	<u>135,172</u>	<u>142,338</u>
Revenues Available for Debt Service	<u><u>\$939,042</u></u>	<u><u>\$1,209,901</u></u>	<u><u>\$720,369</u></u>
Gas			
Total Operating Revenues	\$810,123	\$753,082	\$754,045
Less: Operating Expenses	<u>(872,157)</u>	<u>(870,933)</u>	<u>(761,930)</u>
Operating Income	(\$62,034)	(\$117,851)	(\$7,885)
Plus: Depreciation	<u>54,226</u>	<u>42,340</u>	<u>37,821</u>
Revenues Available for Debt Service	<u><u>(\$7,808)</u></u>	<u><u>(\$75,511)</u></u>	<u><u>\$29,936</u></u>

Continued on next page

¹ The higher than normal operating expenses in 2025 were due to the City's planned improvements to upgrade the sewer plant. Depreciation also increased during that period.

ENTERPRISE FUNDS continued

	2023 Audited	2024 Audited	2025 Audited
Municipal Liquor Store			
Total Operating Revenues	\$793,983	\$693,286	\$1,414,015
Less: Operating Expenses	<u>(669,561)</u>	<u>(718,176)</u>	<u>(1,118,683)</u>
Operating Income	\$124,422	(\$24,890)	\$295,332
Plus: Depreciation	<u>14,323</u>	<u>14,323</u>	<u>213,351</u>
Revenues Available for Debt Service	<u><u>\$138,745</u></u>	<u><u>(\$10,567)</u></u>	<u><u>\$508,683</u></u>
Stormwater			
Total Operating Revenues	\$167,383	\$173,215	\$160,175
Less: Operating Expenses	<u>(55,309)</u>	<u>(56,919)</u>	<u>(71,049)</u>
Operating Income	\$112,074	\$116,296	\$89,126
Plus: Depreciation	<u>39,484</u>	<u>39,829</u>	<u>38,388</u>
Revenues Available for Debt Service	<u><u>\$151,558</u></u>	<u><u>\$156,125</u></u>	<u><u>\$127,514</u></u>
Campground			
Total Operating Revenues	\$935,226	\$961,856	\$961,319
Less: Operating Expenses	<u>(344,226)</u>	<u>(403,744)</u>	<u>(408,897)</u>
Operating Income	\$591,000	\$558,112	\$552,422
Plus: Depreciation	<u>63,649</u>	<u>63,650</u>	<u>80,817</u>
Revenues Available for Debt Service	<u><u>\$654,649</u></u>	<u><u>\$621,762</u></u>	<u><u>\$633,239</u></u>

SUMMARY GENERAL FUND INFORMATION

The following are summaries of the revenues, 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 2025 audited financial statements.

COMBINED STATEMENT	FISCAL YEAR ENDING DECEMBER 31				
	2021 Audited	2022 Audited	2023 Audited	2024 Audited	2025 Audited
Revenues					
Property taxes	\$1,899,444	\$2,044,614	\$2,111,612	\$2,134,306	\$2,131,499
Special assessments	0	12	0	0	0
Licenses and permits	53,930	53,458	95,659	51,685	70,990
Intergovernmental	2,475,868	2,856,603	2,626,897	2,713,642	2,844,403
Charges for services	194,607	158,474	189,520	176,929	255,855
Fine and forfeitures	7,472	5,279	5,169	6,193	5,248
Investment income	2,215	(366)	46,493	0	0
Other	50,344	57,645	41,045	149,684	179,731
Total Revenues	<u>\$4,683,880</u>	<u>\$5,175,719</u>	<u>\$5,116,395</u>	<u>\$5,232,439</u>	<u>\$5,487,726</u>
Expenditures					
General government	\$629,872	\$726,193	\$674,546	\$702,807	\$910,080
Public safety	1,438,749	1,649,038	1,626,961	1,751,242	1,905,679
Public works	1,348,997	1,320,128	1,390,682	1,468,027	1,440,305
Culture and recreation	169,059	206,981	198,619	255,350	348,927
Health and welfare	112,308	120,368	131,405	138,608	139,378
Miscellaneous	153,035	175,251	190,398	261,504	166,841
Total Expenditures	<u>\$3,852,020</u>	<u>\$4,197,959</u>	<u>\$4,212,611</u>	<u>\$4,577,538</u>	<u>\$4,911,210</u>
Excess of revenues over (under) expenditures	\$831,860	\$977,760	\$903,784	\$654,901	\$576,516
Other Financing Sources (Uses)					
Proceeds from sale of capital asset	\$21,245	\$0	\$0	\$0	\$0
Insurance proceeds	0	11,000	0	4,474	0
Transfers in	385,634	430,967	311,198	613,745	612,034
Transfers (out)	(1,325,050)	(725,250)	(979,550)	(336,300)	(421,550)
Total Other Financing Sources (Uses)	<u>(918,171)</u>	<u>(283,283)</u>	<u>(668,352)</u>	<u>281,919</u>	<u>190,484</u>
Net changes in Fund Balances	(\$86,311)	\$694,477	\$235,432	\$936,820	\$767,000
General Fund Balance January 1	\$2,092,946	\$2,006,635	\$2,701,112	\$2,936,544	\$3,873,364
Residual Equity Transfer in (out)	0	0	0	0	0
General Fund Balance December 31	\$2,006,635	\$2,701,112	\$2,936,544	\$3,873,364	\$4,640,364
DETAILS OF DECEMBER 31 FUND BALANCE					
Assigned	\$20,571	\$26,853	\$25,862	\$26,476	\$21,337
Restricted	0	0	178,894	178,894	178,894
Unassigned	1,986,064	2,674,259	2,731,788	3,667,994	4,440,133
Total	<u>\$2,006,635</u>	<u>\$2,701,112</u>	<u>\$2,936,544</u>	<u>\$3,873,364</u>	<u>\$4,640,364</u>

GENERAL FUND BUDGET SUMMARY

COMBINED STATEMENT

FISCAL YEAR ENDING DECEMBER 31

	2026 Adopted Budget¹
Revenues	
Property taxes	\$2,215,147
Other taxes	\$17,500
Intergovernmental	574,986
Licenses and permits	208,425
Fine and forfeitures	50
Public charges for services	63,500
Interest on investments	12,000
Miscellaneous	125,000
Total Revenues	<u>\$3,216,608</u>
Expenditures	
General government	\$419,550
Public safety	467,400
Public Works	674,100
Health and human services	5,500
Culture, recreation and education	19,200
Conservation and development	237,500
Debt service	1,266,340
Capital outlay	544,990
Total Expenditures	<u>\$3,634,580</u>
Excess of revenues over (under) expenditures	(\$417,973)
Other Financing Sources (Uses)	
Transfers in	\$417,973
Transfers (out)	0
Total Other Financing Sources (Uses)	<u>\$417,973</u>
Net changes in Fund Balances	\$0

¹ The 2026 budget was adopted on November 18, 2025.

GENERAL INFORMATION

LOCATION

The City, with a 2020 U.S. Census population of 3,633 and a 2024 population estimate of 3,508, comprising an area of 3.30 square miles and is approximately 20 miles north of Duluth, Minnesota and 178 miles northeast of St. Paul, Minnesota.

LARGER EMPLOYERS¹

Larger employers in the City include the following:

Firm	Type of Business/Product	Estimated No. of Employees
Aspirus Lake View Hospital and Clinics	Hospital and clinic	170
Labounty Manufacturing Inc	Cutting tool and machinery manufacturing	160
Lake County	County government and services	153
LP Building Solutions	Building materials manufacturer	108
The City	Municipal government and services	107
Serco Loaders	Construction Machinery & Equipment	100
Larsmont Cottages	Cottages, cabins and restaurants	80
Ecumen - Sunrise on Superior ²	Residential care homes	78
Splashing Rock Restaurant	Full service restaurant	70
Super One Foods	Grocers-retail	70

Source: Data Axle Reference Solutions, written and telephone survey, 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.

² Previously known as Waterview Shores.

BUILDING PERMITS (as of April 14, 2026)

	2022	2023	2024	2025	2026
<u>New Single Family Homes</u>					
No. of building permits	2	3	1	2	0
Valuation	\$588,700	\$757,300	\$190,400	\$447,000	\$0
<u>New Commercial/Industrial</u>					
No. of building permits	0	1	1	1	0
Valuation	\$0	\$310,720	\$4,500,000	\$2,877,977	\$0
<u>All Building Permits</u> <i>(including additions and remodelings)</i>					
No. of building permits	74	87	87	90	11
Valuation	\$2,250,376	\$15,972,935	\$6,197,402	\$5,371,057	\$1,694,956

Source: The City.

U.S. CENSUS DATA**Population Trend:** The City

2010 U.S. Census population	3,745
2020 U.S. Census population	3,633
Percent of Change 2010 - 2020	-2.99%
2024 State Demographer Population Estimate	3,508

Income and Age Statistics

	The City	Lake County	State of Minnesota	United States
2024 per capita income	\$33,078	\$41,362	\$48,237	\$44,673
2024 median household income	\$65,625	\$75,541	\$89,062	\$80,734
2024 median family income	\$80,521	\$94,747	\$113,993	\$99,999
2024 median gross rent	\$1,079	\$1,093	\$1,280	\$1,413
2024 median value owner occupied units	\$206,800	\$241,300	\$329,300	\$332,700
2024 median age	41.2 yrs.	49.4 yrs.	38.8 yrs.	38.9 yrs.

	State of Minnesota	United States
City % of 2024 per capita income	68.57%	74.04%
City % of 2024 median family income	70.64%	80.52%

Housing Statistics

	<u>The City</u>		Percent of Change
	2020	2024	
All Housing Units	1,588	1,596	0.50%

Source: 2010 and 2020 Census of Population and Housing, and 2024 American Community Survey (Based on a five-year estimate), U.S. Census Bureau (<https://data.census.gov>), and Minnesota State Demographer (<https://mn.gov/admin/demography/data-by-topic/population-data/our-estimates/>).

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	State of Minnesota	
2022	4,943	4.6%	2.5%	
2023	4,965	4.0%	2.8%	
2024	5,035	3.3%	3.1%	
2025	5,091	4.2%	3.9%	
2026, April	4,890	4.3%	4.0%	

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 or engaged the Auditor to perform, and the Auditor has not performed, any additional examination, assessments, procedures or evaluation with respect to such financial statements since the date thereof or with respect to this Preliminary Official Statement, nor has the City requested that the Auditor consent to the use of such financial statements in this Preliminary Official Statement. Although the inclusion of the financial statements in this Preliminary 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**

Basic Financial Statements

December 31, 2025

**City of Two Harbors
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**City of Two Harbors
Elected Officials
December 31, 2025**

<u>Elected Officials</u>	<u>Position</u>	<u>Term Expires</u>
Lew Conner	Mayor	December 31, 2026
Robin Glaser	Alderman At-Large	December 31, 2028
Ben Redden	Alderman Second Ward	December 31, 2026
Uriah Hefter	Alderman First Ward	December 31, 2026
Catherine Erickson	Alderman Third Ward	December 31, 2028
Todd Redmann	Alderman Fourth Ward	December 31, 2028
Donna Heil	Alderman At-Large	December 31, 2026

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Independent Auditor's Report

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

Report on the Audit of the Financial Statements

Opinions

We have audited the financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of , as of and for the year ended December 31, 2025, and the related notes to the basic financial statements, which collectively comprise ' basic financial statements as listed in the Table of Contents.

In our opinion, the accompanying financial statements present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of , as of December 31, 2025, and the respective changes in financial position and, where applicable, cash flows thereof and the respective budgetary comparisons for the General Fund for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinions

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Responsibilities of Management for the Financial Statements

The City of Two Harbors' management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ' ability to continue as a going concern for twelve months beyond the financial statement date, including any currently known information that may raise substantial doubt shortly thereafter.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinions. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS and *Government Auditing Standards* will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS and *Government Auditing Standards*, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit 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 ' internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ' ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

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 Required Supplementary Information as listed in the Table of Contents be presented to supplement the basic financial statements. Such information is the responsibility of management and, 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.

Supplementary 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 presented in table of contents and the Schedule of Expenditures of Federal Awards as required by *Title 2 U.S. Code of Federal Regulations (CFR) Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* are presented for purposes of additional analysis and are not a required part of the basic financial statements.

Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The 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 accompanying supplementary information and the Schedule of Expenditures of Federal Awards are 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 1, 2026, 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 solely 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 the effectiveness of 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 14, 2026

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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, 2025, 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 \$88,099,946 as of December 31, 2025. The net position of the governmental activities was \$19,685,623. The net position of the business-type activities was \$68,414,323.
- The City's governmental funds reported a total combined ending fund balance of \$10,844,681, a decrease of \$2,856,036 from 2024.
- The General Fund unassigned fund balance was \$4,440,133 or 90.41% of total General Fund expenditures for 2025, compared to \$3,667,994 or 80.13% for 2024.
- The Proprietary Fund unrestricted net position was \$ 15,975,677 or 198% of total Proprietary Fund operating expenses for 2025, compared to \$15,670,661 , or 247% of the same for 2024.
- The City's total debt decreased by \$936,347 during the current year.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis are 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, deferred outflows, liabilities, and deferred inflows. The difference between assets plus deferred outflows and liabilities plus deferred inflows is 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.

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).

City of Two Harbors Management's Discussion and Analysis

GOVERNMENT-WIDE FINANCIAL STATEMENTS (CONTINUED)

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 one component unit, the Two Harbors Economic Development Authority.

The government-wide financial statements can be found on pages 21-23 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.

The City maintains fifteen individual governmental funds. Of these funds, four 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, Capital Equipment Fund, Street Improvement Fund and GO Bond Debt Service 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 in Supplementary Information section of this report beginning on page 103.

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

The basic governmental fund financial statements can be found on pages 24-31 of this report.

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

FUND FINANCIAL STATEMENTS (CONTINUED)

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 32-37 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 38 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 39-79 of this report.

REQUIRED SUPPLEMENTAL INFORMATION

In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information. The required supplemental information can be found on pages 82-100 of this report.

The combining statements referred to earlier, in connection with non-major governmental funds and internal service funds, are presented immediately following the required supplemental information beginning on page 103.

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

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Statement of Net Position - The following table presents the primary government's net position as of December 31, 2025, with a comparison to 2024.

	Governmental Activities		Business-Type Activities		Total	
	2025	2024	2025	2024	2025	2024
Assets						
Current and other assets	\$ 13,145,796	\$ 15,720,128	\$ 22,921,183	\$ 24,346,447	\$ 36,066,979	\$ 40,066,575
Capital assets	22,642,244	19,139,270	71,037,959	70,391,842	93,680,203	89,531,112
Total assets	\$ 35,788,040	\$ 34,859,398	\$ 93,959,142	\$ 94,738,289	\$ 129,747,182	\$ 129,597,687
Deferred Outflows of Resources						
Related to OPEB	\$ 128,415	\$ 104,185	\$ 109,427	\$ 98,438	\$ 237,842	\$ 202,623
Related to fire relief pensions	102,539	101,654	-	-	102,539	101,654
Related to city pensions	1,111,259	1,301,586	168,574	164,410	1,279,833	1,465,996
Total deferred outflows of resources	\$ 1,342,213	\$ 1,507,425	\$ 278,001	\$ 262,848	\$ 1,620,214	\$ 1,770,273
Liabilities						
Long-term liabilities outstanding	\$ 14,321,405	\$ 14,629,684	\$ 21,603,927	\$ 22,066,655	\$ 35,925,332	\$ 36,696,339
Other liabilities	1,413,270	1,117,009	3,716,863	5,723,646	5,130,133	6,840,655
Total liabilities	\$ 15,734,675	\$ 15,746,693	\$ 25,320,790	\$ 27,790,301	\$ 41,055,465	\$ 43,536,994
Deferred Inflows of Resources						
Related to fire relief pensions	\$ 189,679	\$ 60,294	\$ -	\$ -	\$ 189,679	\$ 60,294
Related to city pensions	1,520,276	1,806,669	502,030	670,947	2,022,306	2,477,616
Total deferred inflows of resources	\$ 1,709,955	\$ 1,866,963	\$ 502,030	\$ 670,947	\$ 2,211,985	\$ 2,537,910
Net Position						
Net investment in capital assets	\$ 11,906,583	\$ 10,831,101	\$ 51,762,155	\$ 50,298,550	\$ 63,668,738	\$ 61,129,651
Restricted	1,947,976	2,041,660	676,491	570,678	2,624,467	2,612,338
Unrestricted	5,831,064	5,880,406	15,975,677	15,670,661	21,806,741	21,551,067
Total net position	\$ 19,685,623	\$ 18,753,167	\$ 68,414,323	\$ 66,539,889	\$ 88,099,946	\$ 85,293,056

The largest portion of the City's net position reflects its \$63,668,738 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.

Restricted net position is 3% of the City's net position which represents resources that are subject to external restrictions on how they may be used.

The remaining \$21,806,741 represents the unrestricted portion of the City's net position. This is an increase of \$255,674 from the 2024 unrestricted net position. The increase in unrestricted net position is the result of a multitude of factors, including an increase in overall net position of the city offset by additional restriction to net position as noted above. Unrestricted net position may be used to meet the government's ongoing obligations to citizens and creditors.

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

GOVERNMENT-WIDE FINANCIAL ANALYSIS (CONTINUED)

Statement of Activities - The following table gives users a better understanding of the sources and uses of the City's net position, represents the changes in net position for governmental and business-type activities. The governmental activities net position increased \$932,456 while the business-type activities net position increased by \$1,962,434.

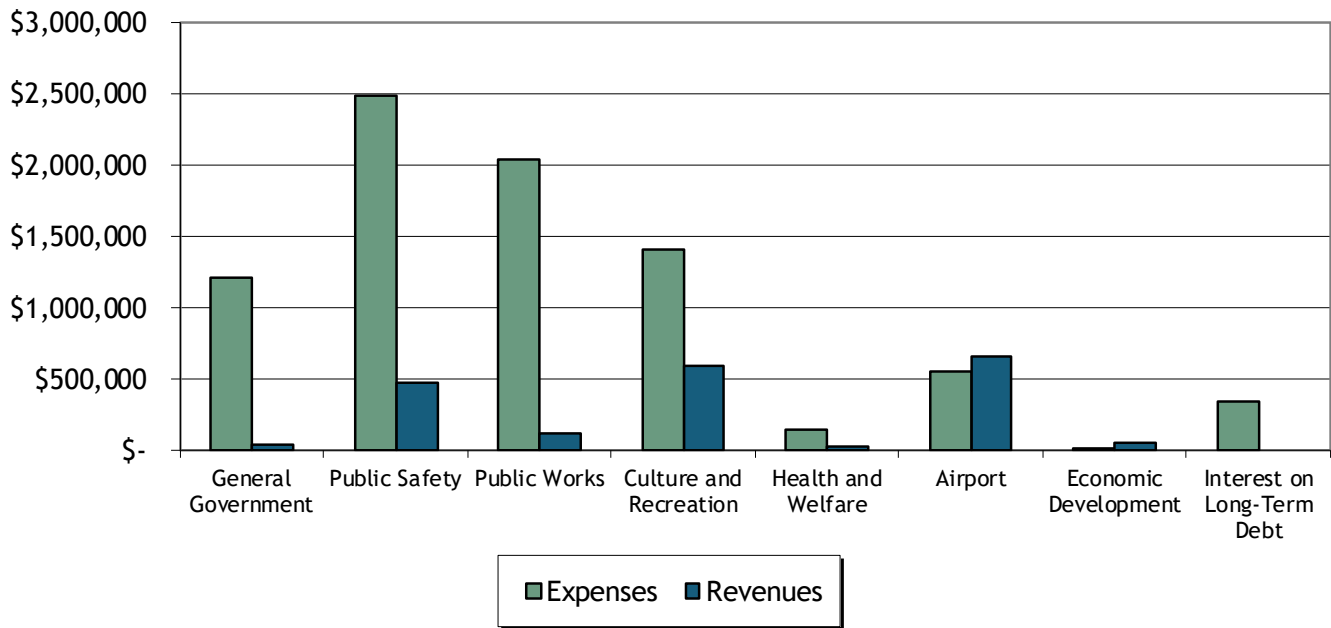
	Governmental Activities		Business-Type Activities		Total	
	2025	2024	2025	2024	2025	2024
Revenues						
Program revenues						
Charges for services	\$ 1,047,961	\$ 906,954	\$ 14,892,665	\$ 13,757,826	\$ 15,940,626	\$ 14,664,780
Operating grants and contributions	410,690	416,241	-	315	410,690	416,556
Capital grants and contributions	519,688	1,505,060	1,714,937	5,271,551	2,234,625	6,776,611
General revenues						
Taxes	3,229,924	3,316,864	-	-	3,229,924	3,316,864
General state aids	2,786,691	2,730,696	-	36,494	2,786,691	2,767,190
Investment income	443,944	439,921	1,071,610	814,948	1,515,554	1,254,869
Other general revenue	81,054	56,513	-	-	81,054	56,513
Gain on sale of asset	158,001	89,933	-	-	158,001	89,933
Total revenues	<u>8,677,953</u>	<u>9,462,182</u>	<u>17,679,212</u>	<u>19,881,134</u>	<u>26,357,165</u>	<u>29,343,316</u>
Expenses						
General government	1,215,730	1,078,047	-	-	1,215,730	1,078,047
Public safety	2,489,818	2,121,427	-	-	2,489,818	2,121,427
Public works	2,044,449	2,123,626	-	-	2,044,449	2,123,626
Culture and recreation	1,416,546	1,210,768	-	-	1,416,546	1,210,768
Health and welfare	150,940	181,076	-	-	150,940	181,076
Airport	554,258	700,362	-	-	554,258	700,362
Economic development	109	216	-	-	109	216
Interest on long-term debt	343,207	393,927	-	-	343,207	393,927
Water	-	-	1,729,668	1,414,220	1,729,668	1,414,220
Sewage disposal	-	-	3,026,385	2,032,594	3,026,385	2,032,594
Electric	-	-	3,410,023	3,048,101	3,410,023	3,048,101
Gas	-	-	2,968,705	2,779,589	2,968,705	2,779,589
Liquor	-	-	3,554,746	2,900,607	3,554,746	2,900,607
Stormwater	-	-	95,136	82,443	95,136	82,443
Campground	-	-	462,555	451,090	462,555	451,090
Total expenses	<u>8,215,057</u>	<u>7,809,449</u>	<u>15,247,218</u>	<u>12,708,644</u>	<u>23,462,275</u>	<u>20,518,093</u>
Transfers	469,560	575,521	(469,560)	(575,521)	-	-
Change in net position	932,456	2,228,254	1,962,434	6,596,969	2,894,890	8,825,223
Net Position - Beginning, as previously stated	18,753,167	-	66,539,889	-	-	-
Prior Period Restatement (See Note 13)	-	-	(88,000)	-	-	-
Net Position - Beginning	<u>18,753,167</u>	<u>16,524,913</u>	<u>66,451,889</u>	<u>59,942,920</u>	<u>85,205,056</u>	<u>76,467,833</u>
Net Position - Ending	<u>\$ 19,685,623</u>	<u>\$ 18,753,167</u>	<u>\$ 68,414,323</u>	<u>\$ 66,539,889</u>	<u>\$ 88,099,946</u>	<u>\$ 85,293,056</u>

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:

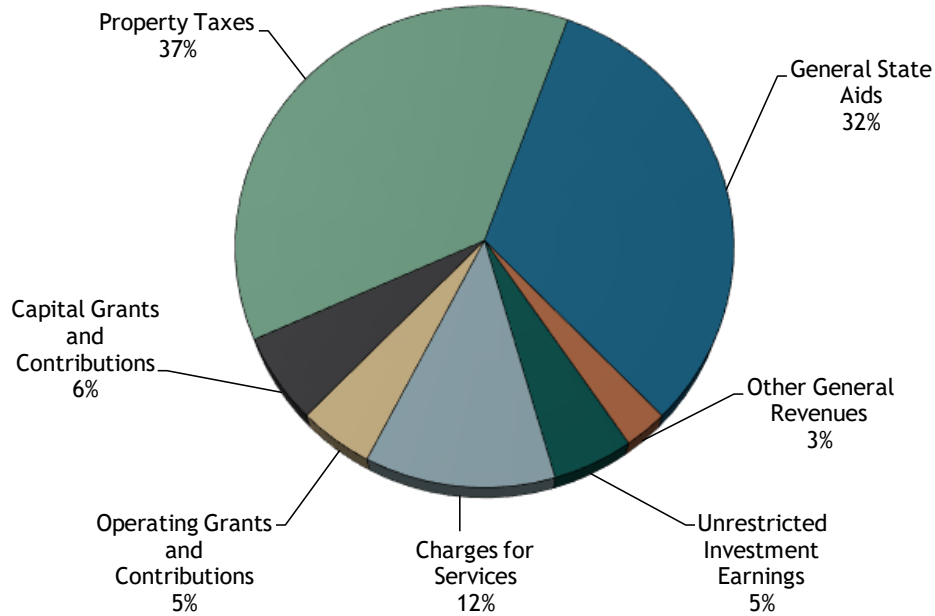
Expenses and Program Revenues - Governmental Activities



City of Two Harbors
Management's Discussion and Analysis

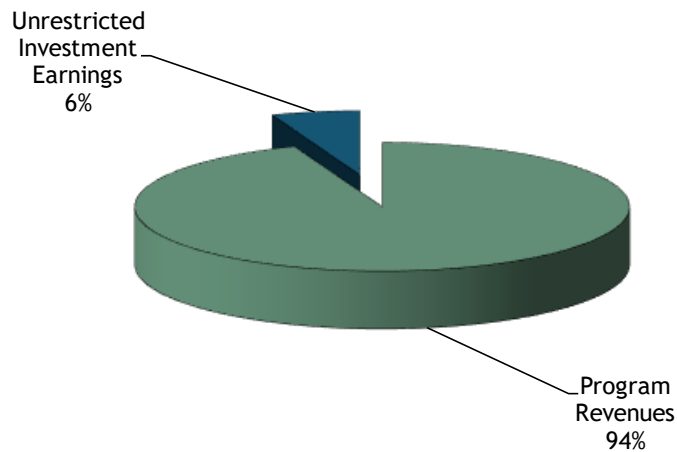
GOVERNMENT-WIDE FINANCIAL ANALYSIS (CONTINUED)

Revenues by Source - Governmental Activities



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

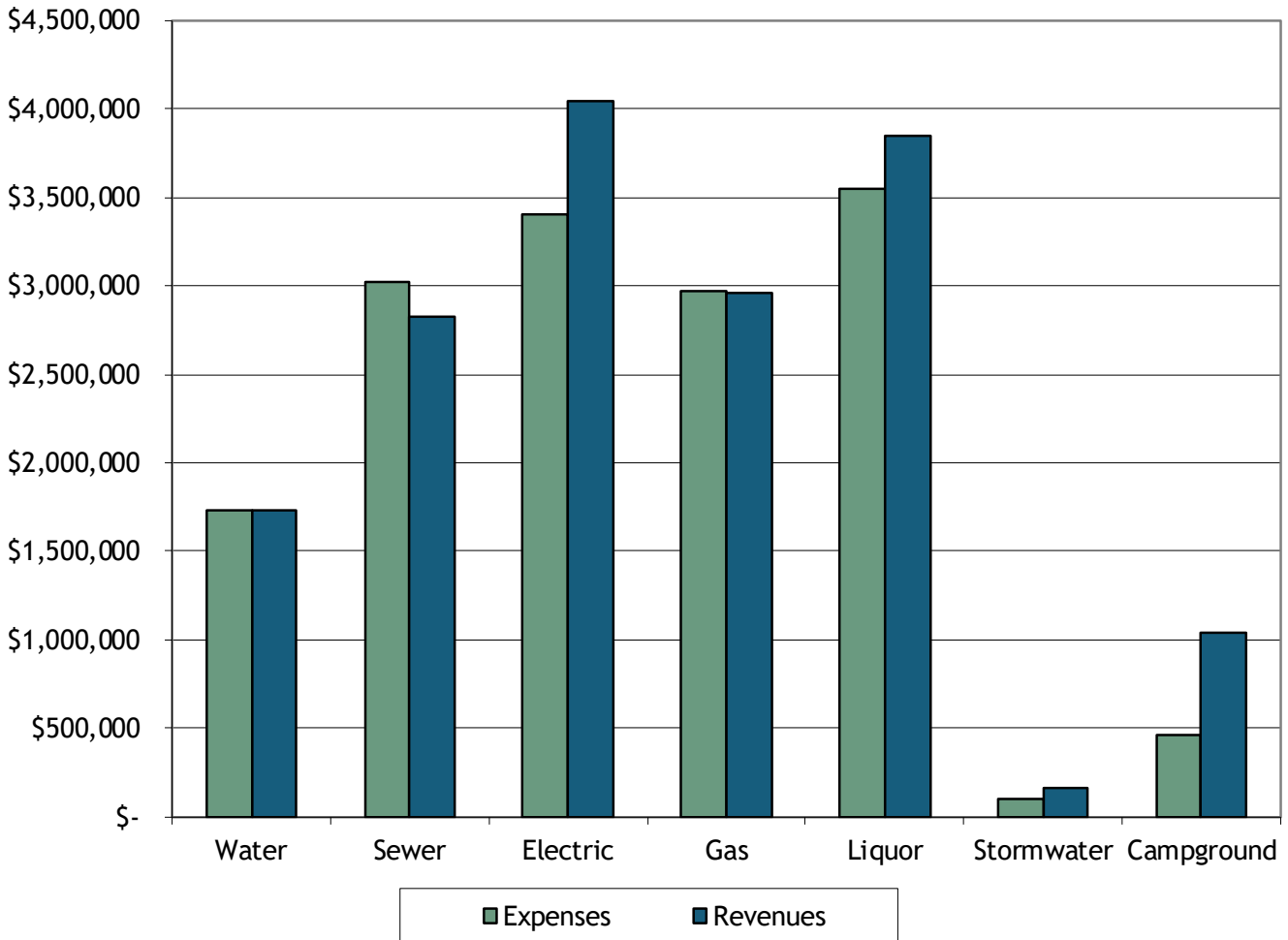
Revenues by Source - Business-Type Activities



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

GOVERNMENT-WIDE FINANCIAL ANALYSIS (CONTINUED)

Expenses and Program Revenues - Business-Type Activities



Governmental Activities

The governmental activities increased the City's net position by \$932,456 compared to an increase of \$2,228,254 in 2024. Total governmental revenues decreased by 8% from 2024 to 2025, total expenses increased by 5% over the same period. The decrease in revenues is attributable mainly to federal and state funding in 2024 for multiple airport projects.

Business-Type Activities

Business-type activities increased the City's net position by \$1,962,434 compared with an increase of \$6,596,969 in 2024. This can be attributed funding significant projects in 2024 compared to 2025, related to the Wastewater Treatment Plant and Water Chlorine Tank Projects.

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

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 2025, the City's governmental funds reported a combined fund balance of \$10,844,681, a decrease of \$2,856,036 in comparison with the prior year. The non-spendable, committed, assigned, and unassigned portion of the fund balance is \$8,004,658 or 74%, which is available for spending at the City's discretion. \$2,840,023 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 \$4,440,133, and total fund balance was \$4,640,364. 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 90% of total General Fund expenditures, while total fund balance represents 94% of that same amount. The General Fund increased \$767,000 and the key factors are discussed in the General Fund Budgetary Highlights.

The Street Improvement Fund was created in 2017 to track the expenditures related to the implementation of the Capital Improvement Plan. At the end of the current year, the assigned fund balance was \$730,468, this is a decrease of \$2,773,058 from prior year, attributed construction the 2024-2025 Street Improvement Project nearing completion in 2025.

Funding for the Street Improvement Fund is from G.O. Bonds, transfers from the General Fund and Sales Tax Fund which was implemented on October 1, 2019, with the collection of .5% sales tax for the funding of the Street Improvement Projects.

The Capital Equipment Fund is the funding source for the governmental capital projects. This includes Public Safety, Public Works, Parks, Cemetery, Library, Airport and Golf. At the end of the current year, the nonspendable, restricted, and assigned fund balance was \$473,451, this is an decrease of \$925,290 from prior year, attributed to \$1,265,000 bonding in 2024 to support a \$952,000 fire engine purchase and a loader in Public Works which was completed in 2025.

The G.O. Bond Debt Service Fund is a funding source for debt related to the street improvement projects. This fund is supported from special assessments, transfers in from the sales tax fund for funding of the Street Improvement Projects and discretionary funding from the campground. There was a restricted fund balance in 2025 of \$704,959 an decrease of \$135,892 in comparison to prior year.

**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 \$68,414,323. The net position increased by \$1,874,434 from last year's total of \$66,539,889. Net position consists of 76% investment in capital assets, 1% restricted per PFA guidelines for a Water and Wastewater Replacement Fund and 23% unrestricted, or available for spending at the City's discretion. Other factors concerning the finances of these funds have already been addressed in the discussion of the City's business-type activities.

GENERAL FUND BUDGETARY HIGHLIGHTS

The final budget called for a \$544 increase in fund balance, actual increase in fund balance was \$767,000. Actual revenues were \$224,916 more than budgeted. This is due to the reimbursement from the state for assistance in the 2025 wildfires, interest rate increases in investment income and budgeting conservatively.

The actual General Fund expenditures of \$4,911,210 were under budget by \$541,540 of the final budget of \$5,452,750. This can be mainly be attributed to unfilled positions in several departments, including Police and Public Works.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

The City's total capital assets for its governmental and business-type activities as of December 31, 2025, were \$93,680,203 (net of accumulated depreciation/amortization). 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. The City's investment in capital assets for the current fiscal year included a 18% increase in governmental activities and an increase of 1% in business-type activities.

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

- Construction for the 2024-2025 Street Improvement Project began spring 2024 with total costs in 2025 of \$2,902,860, construction will be completed in Spring 2026.
- Construction for the \$33.5M Wastewater Treatment Plant project; the project is expected to be completed in 2026. \$1,859,838 was expended in 2025.
- Construction began in 2023 for the Water Treatment Plant Improvements Project. This project addresses the water loss caused by the leaking chlorine contact tank, Minnesota Department of Health code violation issues, and building deterioration which needs protection. Total project costs are anticipated at \$8,742,361 with a \$5 million grant from the Minnesota Public Facilities Authority. \$666,071 was expended in 2025.
- The Two Harbors Municipal Airport completed the Terminal Building Project in 2025. The city received funding through the Bipartisan Infrastructure Law (BIL) allocated for airport terminal development projects. The city's request was for a 1,300-SF building to replace the existing with a total project cost of \$1.2 million. The FAA share is 95%, with the state funding the remaining 5%. Construction began in September 2024, 2025 project costs were \$449,342.

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

CAPITAL ASSET AND DEBT ADMINISTRATION (CONTINUED)

Capital Assets (Continued)

The following table summarized capital assets for governmental and business-type activities for 2025 and 2024:

Capital Assets (Net of Depreciation/Amortization)

	Governmental Activities		Business-Type Activities		Total	
	2025	2024	2025	2024	2025	2024
Land	\$ 616,081	\$ 616,081	\$ 1,890,248	\$ 1,890,248	\$ 2,506,329	\$ 2,506,329
Inexhaustible asset	281,528	281,528	-	-	281,528	281,528
Construction in progress	5,759,229	3,986,098	926,221	422,371	6,685,450	4,408,469
Buildings	3,919,646	2,591,235	53,823,119	53,113,310	57,742,765	55,704,545
Structures and improvements	8,464,203	8,786,901	13,801,389	14,469,474	22,265,592	23,256,375
Machinery and equipment	3,601,557	2,877,427	596,982	496,439	4,198,539	3,373,866
Total	\$ 22,642,244	\$ 19,139,270	\$ 71,037,959	\$ 70,391,842	\$ 93,680,203	\$ 89,531,112

Additional information on the City's capital assets can be found in Note 5.

Long-Term Debt - As of December 31, 2025, the City had total long-term bonds and notes outstanding of \$29,638,967. This amount decreased \$ 936,347 during 2025, new debt issuances included \$433,232 for the Wastewater Treatment Plant Project and \$287,679 for the Water Treatment Improvement Project, debt issuances were offset by principal payments made in 2025. The following table shows various classifications of the City's long-term bonds and notes on December 31, 2025.

	Governmental Activities		Business-Type Activities		Total	
	2025	2024	2025	2024	2025	2024
General obligation bonds	\$ 10,145,000	\$ 10,620,000	\$ 750,000	\$ 785,000	\$ 10,895,000	\$ 11,405,000
Unamortized bond premium	575,092	622,381	40,483	43,897	615,575	666,278
General obligation revenue notes	-	-	18,112,823	18,442,511	18,112,823	18,442,511
Leases	15,569	61,525	-	-	15,569	61,525
Total	\$ 10,735,661	\$ 11,303,906	\$ 18,903,306	\$ 19,271,408	\$ 29,638,967	\$ 30,575,314

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 6 of this report.

HISTORICAL AND LONG-TERM FINANCIAL PLANNING

The Mayor and City Council continues to take a long-term view on the City's finances. The following areas are those with the most significant impacts:

The city is considering significant potential investments in extending the infrastructure to serve new development and at the same time reinvesting in its existing infrastructure through street and reconstruction projects and utility main replacements.

City of Two Harbors Management's Discussion and Analysis

HISTORICAL AND LONG-TERM FINANCIAL PLANNING (CONTINUED)

The city is working with Ehler's to update the Financial Management Plan, Utility Rate Study, and a Connection Fee Study. The plans will give the city confidence to fund our projects with an understanding of how they will impact finances of the city and its taxpayers. The model ties budget, levy, and tax information together to provide a complete financial picture.

Budget Outlook

The City's future financial outlook is stable.

- For 2026, the Council Adopted Budget for all City funds was \$38.4 million which represents a \$ 2.1 million or 5% decrease from the 2025 Council Adopted Budget of \$40.5 million.
- At the same time, the Council adopted a 2026 property tax levy of \$2,716,979 which results in a 4.2% or \$108,321 increase, from the 2025 adopted property tax levy. As part of this budget, funds that have accumulated in various City funds due to a growing economy and fiscal restraint in prior years allows for utilization of fund balances, operating capital items, and other one-time items.

The City also reviews the rates of the water, sewer, electric, sewer and storm water funds. As part of the process the City projects fund balances and capital improvements to each of the systems for the next ten years and identifies required changes to user and connection rates for each fund.

Employment

Lake County's unemployment rate being a bit higher than Minnesota's (and sometimes the U.S.) isn't unusual, and it mostly comes down to rural economics, industry mix, and seasonality rather than one single issue. The unemployment rate for Lake County, where the City is located, is currently 6.0%, which is higher than the rate of 4.8% a year ago. This is higher than the national average unemployment rate of 4.7% and higher than the State's average unemployment rate of 5.3% for the same time period.

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.

BASIC FINANCIAL STATEMENTS

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City of Two Harbors
Statement of Net Position
December 31, 2025

	Governmental Activities	Business-Type Activities	Total	Two Harbors Economic Development Authority
Assets				
Cash and investments (including cash equivalents)	\$ 11,172,471	\$ 18,714,325	\$ 29,886,796	\$ 94,620
Restricted cash (including cash equivalents)	-	676,491	676,491	-
Property tax receivable	81,652	-	81,652	-
Accounts receivable	253,922	1,382,923	1,636,845	-
Interest receivable	17,073	44,601	61,674	62
Due from other governments	494,344	1,165,406	1,659,750	-
Notes receivable	143,588	-	143,588	-
Deferred special assessments receivable	726,708	29,794	756,502	-
Inventories	28,140	907,643	935,783	-
Capital assets				
Land	616,081	1,890,248	2,506,329	-
Inexhaustible asset	281,528	-	281,528	-
Construction in progress	5,759,229	926,221	6,685,450	-
Capital assets being depreciated/amortized				
Buildings	7,614,259	67,510,626	75,124,885	-
Improvements	19,458,476	27,451,990	46,910,466	-
Structures	311,156	-	311,156	-
Machinery and equipment	8,181,583	3,830,653	12,012,236	-
Lease machinery and equipment	152,505	-	152,505	-
Less accumulated depreciation/amortization	(19,732,573)	(30,571,779)	(50,304,352)	-
Net pension asset	227,898	-	227,898	-
Total assets	<u>35,788,040</u>	<u>93,959,142</u>	<u>129,747,182</u>	<u>94,682</u>
Deferred Outflows of Resources				
Deferred outflows of resources related to OPEB	128,415	109,427	237,842	-
Deferred outflows of resources related to fire relief pensions	102,539	-	102,539	-
Deferred outflows of resources related to city pensions	1,111,259	168,574	1,279,833	-
Total deferred outflow of resources	<u>1,342,213</u>	<u>278,001</u>	<u>1,620,214</u>	<u>-</u>
Total assets and deferred outflows of resources	<u>\$ 37,130,253</u>	<u>\$ 94,237,143</u>	<u>\$ 131,367,396</u>	<u>\$ 94,682</u>
Liabilities				
Accounts payable	\$ 829,758	\$ 1,217,601	\$ 2,047,359	\$ -
Contracts payable	193,556	382,009	575,565	-
Due to other governments	-	3,620	3,620	-
Accrued payroll	178,138	129,433	307,571	-
Accrued interest payable	148,413	199,246	347,659	-
Customer deposits	-	83,857	83,857	-
Unearned revenue	63,405	1,701,097	1,764,502	-
Noncurrent liabilities				
Due within one year	1,089,413	1,311,272	2,400,685	-
Due in more than one year	10,701,667	18,467,323	29,168,990	-
Total OPEB liability, due in more than one year	1,320,323	1,125,104	2,445,427	-
Net pension liability, due in more than one year	1,210,002	700,228	1,910,230	-
Total liabilities	<u>15,734,675</u>	<u>25,320,790</u>	<u>41,055,465</u>	<u>-</u>
Deferred Inflows of Resources				
Deferred inflows related to fire relief pensions	189,679	-	189,679	-
Deferred inflows related to city pensions	1,520,276	502,030	2,022,306	-
Total deferred inflows of resources	<u>1,709,955</u>	<u>502,030</u>	<u>2,211,985</u>	<u>-</u>
Net Position				
Net investment in capital assets	11,906,583	51,762,155	63,668,738	-
Restricted for				
Revolving loans	43,515	-	43,515	-
Sales tax appropriations	417,036	-	417,036	-
Public safety	178,894	-	178,894	-
Fire relief pension	227,898	-	227,898	-
Tax increment financing	219,242	-	219,242	-
Cemetery endowment	156,432	-	156,432	-
Debt service	704,959	676,491	1,381,450	-
Unrestricted	5,831,064	15,975,677	21,806,741	94,682
Total net position	<u>19,685,623</u>	<u>68,414,323</u>	<u>88,099,946</u>	<u>94,682</u>
Total liabilities, deferred inflows of resources, and net position	<u>\$ 37,130,253</u>	<u>\$ 94,237,143</u>	<u>\$ 131,367,396</u>	<u>\$ 94,682</u>

**City of Two Harbors
Statement of Activities
Year Ended December 31, 2025**

Functions/Programs	Expenses	Program Revenues		
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions
Governmental activities				
General government	\$ 1,215,730	\$ 38,985	\$ 7,955	\$ -
Public safety	2,489,818	263,078	211,702	-
Public works	2,044,449	39,603	51,419	25,286
Economic development	109	7,230	-	42,333
Culture and recreation	1,416,546	531,111	67,540	-
Health and welfare	150,940	30,408	-	-
Airport	554,258	137,546	72,074	452,069
Interest on long-term debt	343,207	-	-	-
Total governmental activities	8,215,057	1,047,961	410,690	519,688
Business-type activities				
Water	1,729,668	1,352,706	-	376,786
Sewage disposal	3,026,385	1,483,708	-	1,338,151
Electric	3,410,023	4,048,485	-	-
Gas	2,968,705	2,959,928	-	-
Municipal liquor	3,554,746	3,850,078	-	-
Stormwater	95,136	160,175	-	-
Campground	462,555	1,037,585	-	-
Total business-type activities	15,247,218	14,892,665	-	1,714,937
Total governmental and business-type activities	\$ 23,462,275	\$ 15,940,626	\$ 410,690	\$ 2,234,625
Component unit				
Two Harbors Economic Development Authority	-	-	-	-
Total component units	\$ -	\$ -	\$ -	\$ -
General revenues				
Property taxes				
Sales tax				
Unrestricted state aids				
Unrestricted investment earnings				
Other unrestricted revenues				
Gain on sale of capital assets				
Total general revenues				
Transfers				
Change in net position				
Net position - beginning, as previously stated				
Prior period restatement (See Note 13)				
Net position - beginning				
Net position - ending				

Net (Expense) Revenues
and Changes in Net Position

Governmental Activities	Business-Type Activities	Total	Two Harbors Economic Development Authority
\$ (1,168,790)	\$ -	\$ (1,168,790)	\$ -
(2,015,038)	-	(2,015,038)	-
(1,928,141)	-	(1,928,141)	-
49,454	-	49,454	-
(817,895)	-	(817,895)	-
(120,532)	-	(120,532)	-
107,431	-	107,431	-
(343,207)	-	(343,207)	-
<u>(6,236,718)</u>	<u>-</u>	<u>(6,236,718)</u>	<u>-</u>
-	(176)	(176)	-
-	(204,526)	(204,526)	-
-	638,462	638,462	-
-	(8,777)	(8,777)	-
-	295,332	295,332	-
-	65,039	65,039	-
-	575,030	575,030	-
<u>-</u>	<u>1,360,384</u>	<u>1,360,384</u>	<u>-</u>
<u>\$ (6,236,718)</u>	<u>\$ 1,360,384</u>	<u>\$ (4,876,334)</u>	<u>\$ -</u>
-	-	-	-
<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
\$ 2,147,272	\$ -	\$ 2,147,272	\$ -
1,082,652	-	1,082,652	-
2,786,691	-	2,786,691	-
443,944	1,071,610	1,515,554	3,353
81,054	-	81,054	-
158,001	-	158,001	-
<u>6,699,614</u>	<u>1,071,610</u>	<u>7,771,224</u>	<u>3,353</u>
469,560	(469,560)	-	-
932,456	1,962,434	2,894,890	3,353
<u>18,753,167</u>	<u>66,539,889</u>	<u>85,293,056</u>	<u>91,329</u>
-	(88,000)	(88,000)	-
<u>18,753,167</u>	<u>66,451,889</u>	<u>85,205,056</u>	<u>91,329</u>
<u>\$ 19,685,623</u>	<u>\$ 68,414,323</u>	<u>\$ 88,099,946</u>	<u>\$ 94,682</u>

City of Two Harbors
Balance Sheet - Governmental Funds
December 31, 2025

	General Fund (101)	Capital Equipment Fund (401)	Street Improvement Fund (402)	G.O. Bond Debt Service (301)
Assets				
Cash and investments	\$ 4,579,455	\$ 515,000	\$ 1,319,011	\$ 704,187
Taxes receivable - delinquent	81,295	-	-	-
Deferred special assessment receivable	300	19,525	-	706,883
Accounts receivable	48,073	-	-	-
Interest receivable	5,881	859	1,533	1,313
Due from other funds	161,483	-	-	-
Due from other governments	137,863	273,940	-	10,459
Notes receivable	-	-	-	-
Inventories	-	-	-	-
Total assets	<u>\$ 5,014,350</u>	<u>\$ 809,324</u>	<u>\$ 1,320,544</u>	<u>\$ 1,422,842</u>
Liabilities				
Accounts payable	105,703	260,727	407,937	-
Contracts payable	-	11,417	182,139	-
Due to other funds	-	44,204	-	-
Accrued payroll	165,239	-	-	-
Unearned revenue	21,449	-	-	11,000
Total liabilities	<u>292,391</u>	<u>316,348</u>	<u>590,076</u>	<u>11,000</u>
Deferred Inflows of Resources				
Unavailable revenue - property taxes	81,295	-	-	-
Unavailable revenue - special assessments	300	19,525	-	706,883
Total deferred inflows of resources	<u>81,595</u>	<u>19,525</u>	<u>-</u>	<u>706,883</u>
Fund Balances				
Nonspendable	-	-	-	-
Restricted	178,894	-	-	704,959
Committed	-	-	-	-
Assigned	21,337	473,451	730,468	-
Unassigned	4,440,133	-	-	-
Total fund balances	<u>4,640,364</u>	<u>473,451</u>	<u>730,468</u>	<u>704,959</u>
Total liabilities, deferred inflows of resources, and fund balances	<u>\$ 5,014,350</u>	<u>\$ 809,324</u>	<u>\$ 1,320,544</u>	<u>\$ 1,422,842</u>

Other Governmental Funds	Total Governmental Funds
\$ 4,054,818	\$ 11,172,471
357	81,652
-	726,708
205,849	253,922
7,487	17,073
-	161,483
72,082	494,344
143,588	143,588
28,140	28,140
\$ 4,512,321	\$ 13,079,381
55,391	829,758
-	193,556
117,279	161,483
12,899	178,138
30,956	63,405
216,525	1,426,340
357	81,652
-	726,708
357	808,360
28,140	28,140
1,956,170	2,840,023
788,174	788,174
1,522,955	2,748,211
-	4,440,133
4,295,439	10,844,681
\$ 4,512,321	\$ 13,079,381

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City of Two Harbors
Reconciliation of the Balance Sheet to
the Statement of Net Position - Governmental Funds
December 31, 2025

Total fund balances - governmental funds	\$ 10,844,681
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	42,374,817
Less accumulated depreciation/amortization	(19,732,573)
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:	
Bond principal payable	(10,720,092)
Lease liability	(15,569)
Compensated absences payable	(1,055,419)
Total OPEB liability	(1,320,323)
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	81,652
Deferred special assessments	726,708
Deferred outflows of resources and deferred inflows of resources are created as a result of various differences related to pensions and OPEB that are not recognized in the governmental funds that are not recognized in the governmental funds:	
Deferred inflows of resources related to pensions	(1,709,955)
Deferred outflows of resources related to pensions	1,213,798
Deferred outflows of resources related to OPEB	128,415
Net pension liability	(1,210,002)
Fire relief association net pension asset created through contributions to a defined benefit pension plan which is not recognized in the governmental funds.	227,898
Governmental funds do not report a liability for accrued interest until due and payable.	(148,413)
Total net position - governmental activities	\$ 19,685,623

City of Two Harbors
Statement of Revenues, Expenditures, and
Changes in Fund Balances - Governmental Funds
Year Ended December 31, 2025

	General Fund (101)	Capital Equipment Fund (401)	Street Improvement Fund (402)	G.O. Bond Debt Service (301)
Revenues				
Taxes	\$ 2,131,499	\$ -	\$ -	\$ -
Sales tax	-	-	-	-
Special assessments	-	7,767	-	95,955
Licenses and permits	70,990	-	-	-
Intergovernmental	2,844,403	644,077	27,592	-
Charges for services	255,855	49,703	-	-
Fines and forfeitures	5,248	-	-	-
Miscellaneous				
Investment income	139,919	22,010	115,201	18,346
Loan payments	-	-	-	-
Other	39,812	605	-	-
Total revenues	<u>5,487,726</u>	<u>724,162</u>	<u>142,793</u>	<u>114,301</u>
Expenditures				
Current				
General government	910,080	-	-	-
Public safety	1,905,679	-	-	-
Public works	1,440,305	-	-	-
Culture and recreation	348,927	-	-	-
Health and welfare	139,378	-	-	-
Economic development	-	-	-	-
Airport	-	3,290	-	-
Miscellaneous	166,841	-	-	-
Debt service				
Principal	-	235,955	-	285,000
Interest and other charges	-	110,828	-	325,193
Capital outlay				
General government	-	298,827	-	-
Public safety	-	645,482	-	-
Public works	-	118,207	3,065,851	-
Culture and recreation	-	107,808	-	-
Airport	-	696,356	-	-
Total expenditures	<u>4,911,210</u>	<u>2,216,753</u>	<u>3,065,851</u>	<u>610,193</u>
Excess of revenues over (under) expenditures	576,516	(1,492,591)	(2,923,058)	(495,892)
Other Financing Sources (Uses)				
Proceeds from sale of capital asset	-	158,001	-	-
Transfers in	612,034	409,300	150,000	360,000
Transfers out	(421,550)	-	-	-
Total other financing sources (uses)	<u>190,484</u>	<u>567,301</u>	<u>150,000</u>	<u>360,000</u>
Net change in fund balances	767,000	(925,290)	(2,773,058)	(135,892)
Fund Balances				
Beginning of year	3,873,364	1,398,741	3,503,526	840,851
End of year	<u>\$ 4,640,364</u>	<u>\$ 473,451</u>	<u>\$ 730,468</u>	<u>\$ 704,959</u>

See notes to basic financial statements.

Other Governmental Funds	Total Governmental Funds
\$ 33,301	\$ 2,164,800
1,082,652	1,082,652
-	103,722
-	70,990
167,351	3,683,423
695,403	1,000,961
-	5,248
125,113	420,589
4,469	4,469
-	40,417
<u>2,108,289</u>	<u>8,577,271</u>
99,820	1,009,900
-	1,905,679
-	1,440,305
935,042	1,283,969
-	139,378
109	109
207,508	210,798
-	166,841
-	520,955
-	436,021
-	298,827
-	645,482
-	3,184,058
14,382	122,190
-	696,356
<u>1,256,861</u>	<u>12,060,868</u>
851,428	(3,483,597)
-	158,001
458,550	1,989,884
<u>(1,098,774)</u>	<u>(1,520,324)</u>
<u>(640,224)</u>	<u>627,561</u>
211,204	(2,856,036)
<u>4,084,235</u>	<u>13,700,717</u>
<u>\$ 4,295,439</u>	<u>\$ 10,844,681</u>

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, 2025

Net change in fund balances - governmental funds \$ (2,856,036)

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	4,947,793
Depreciation/amortization expense	(1,374,751)
Loss on disposal of capital assets	(70,068)

Compensated absences are recognized as paid in the governmental funds but recognized as the expense is incurred in the Statement of Activities. (193,245)

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. (46,764)

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	(30,923)
State contribution	15,290

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. 520,955

Governmental funds report the effects of bond premiums and discounts when debt is first issued, whereas these amounts are deferred and amortized in the Statement of Activities. 47,290

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. 45,524

The issuance of long-term debt provides current financial resources to governmental funds, Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds:

Special assessments deferred	(78,436)
Delinquent property taxes	5,827

Change in net position - governmental activities \$ 932,456

City of Two Harbors
Statement of Revenues, Expenditures, and
Changes in Fund Balance -
Budget and Actual - General Fund
Year Ended December 31, 2025

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Over (Under)
	Original	Final		
Revenues				
General property taxes	\$ 2,630,427	\$ 2,630,427	\$ 2,113,425	\$ (517,002)
Cable television franchise tax	22,750	22,750	18,074	(4,676)
Licenses and permits	55,700	55,700	70,990	15,290
Intergovernmental	2,286,033	2,286,033	2,844,403	558,370
Charges for services	178,050	178,050	255,855	77,805
Fines and forfeitures	5,600	5,600	5,248	(352)
Miscellaneous revenues				
Investment income	47,200	47,200	139,919	92,719
Other	37,050	37,050	39,812	2,762
Total revenues	<u>5,262,810</u>	<u>5,262,810</u>	<u>5,487,726</u>	<u>224,916</u>
Expenditures				
Current				
General government	1,069,050	1,069,050	910,080	(158,970)
Public safety	1,929,800	1,929,800	1,905,679	(24,121)
Public works	1,786,100	1,786,100	1,440,305	(345,795)
Culture and recreation	299,400	299,400	348,927	49,527
Health and welfare	147,150	147,150	139,378	(7,772)
Miscellaneous	201,250	201,250	166,841	(34,409)
Capital outlay				
Public safety	20,000	20,000	-	(20,000)
Total expenditures	<u>5,452,750</u>	<u>5,452,750</u>	<u>4,911,210</u>	<u>(541,540)</u>
Excess of revenues over (under) expenditures	(189,940)	(189,940)	576,516	766,456
Other Financing Sources (Uses)				
Transfers in	612,034	612,034	612,034	-
Transfers out	(421,550)	(421,550)	(421,550)	-
Total other financing sources (uses)	<u>190,484</u>	<u>190,484</u>	<u>190,484</u>	<u>-</u>
Net change in fund balances	<u>\$ 544</u>	<u>\$ 544</u>	767,000	<u>\$ 766,456</u>
Fund Balance				
Beginning of year			<u>3,873,364</u>	
End of year			<u>\$ 4,640,364</u>	

City of Two Harbors
Statement of Net Position - Proprietary Funds
December 31, 2025

	Water (601)	Sewer (602)	Electric (604)	Gas (605)
Assets				
Current assets				
Cash and cash equivalents	\$ 541,315	\$ 32,247	\$ 124,434	\$ 61,940
Restricted cash and cash equivalents	-	676,491	-	-
Investments	345,000	3,726,125	8,267,564	1,810,678
deferred	5,791	3,811	15,233	4,627
Accounts receivable	132,250	271,651	398,396	563,515
Interest receivable	796	9,238	22,568	8,933
Due from other funds	-	395,364	-	-
Due from other governments	446,502	718,807	57	40
Inventories	-	-	73,927	26,199
Total current assets	<u>1,471,654</u>	<u>5,833,734</u>	<u>8,902,179</u>	<u>2,475,932</u>
Noncurrent assets				
Advances to other funds	-	-	4,040,235	-
Capital assets	28,901,111	52,259,713	5,879,056	2,771,808
Construction in progress	278,175	-	137,900	220,002
Total capital assets	29,179,286	52,259,713	6,016,956	2,991,810
Less accumulated depreciation	(9,193,396)	(12,499,968)	(4,245,322)	(2,556,694)
Capital assets, net of				
Accumulated depreciation	19,985,890	39,759,745	1,771,634	435,116
Total noncurrent assets	<u>19,985,890</u>	<u>39,759,745</u>	<u>5,811,869</u>	<u>435,116</u>
Total assets	<u>21,457,544</u>	<u>45,593,479</u>	<u>14,714,048</u>	<u>2,911,048</u>
Deferred Outflows of Resources				
Deferred outflows of resources related to pension activity	30,615	41,288	33,697	31,619
Deferred outflows of resources related to OPEB	20,582	27,740	22,783	21,297
Total deferred outflows of resources	<u>51,197</u>	<u>69,028</u>	<u>56,480</u>	<u>52,916</u>
Total assets and deferred outflows of resources	<u>\$ 21,508,741</u>	<u>\$ 45,662,507</u>	<u>\$ 14,770,528</u>	<u>\$ 2,963,964</u>
Liabilities				
Current liabilities				
Accounts payable	\$ 205,700	\$ 129,062	\$ 342,169	\$ 386,830
Contracts payable	73,870	298,627	-	-
Accrued payroll	20,526	32,077	25,144	27,073
Accrued interest payable	50,783	57,983	166	-
Unearned revenue	5,791	1,528,811	15,395	4,627
Due to other funds	-	-	-	-
Customer deposits	-	-	61,804	22,053
Due to other governments	-	3,620	-	-
Current portion of long-term debt	681,314	446,569	40,723	72,296
Total current liabilities	<u>1,037,984</u>	<u>2,496,749</u>	<u>485,401</u>	<u>512,879</u>
Long-term liabilities				
Compensated absences, due in more than one year	169,040	197,668	156,109	224,336
Notes from direct borrowings	7,025,292	11,087,531	-	-
Advances from other funds	-	-	-	-
Total OPEB liability	211,621	285,213	234,251	218,972
Net pension liability	127,169	171,505	139,973	131,341
Bonds payable, net	-	-	10,513	-
Less current portion of long-term debt	(681,314)	(446,569)	(40,723)	(72,296)
Total long-term liabilities	<u>6,851,808</u>	<u>11,295,348</u>	<u>500,123</u>	<u>502,353</u>
Total liabilities	<u>7,889,792</u>	<u>13,792,097</u>	<u>985,524</u>	<u>1,015,232</u>
Deferred Inflows of Resources Related to Pension Activity				
Deferred inflows of resources related to pension activity	91,174	122,961	100,354	94,165
Net Position				
Net investment in capital assets	12,886,728	28,373,587	1,761,121	435,116
Restricted	-	676,491	-	-
Unrestricted	641,047	2,697,371	11,923,529	1,419,451
Total net position	<u>13,527,775</u>	<u>31,747,449</u>	<u>13,684,650</u>	<u>1,854,567</u>
Total liabilities, deferred inflows of resources, and net position	<u>\$ 21,508,741</u>	<u>\$ 45,662,507</u>	<u>\$ 14,770,528</u>	<u>\$ 2,963,964</u>

Municipal Liquor (609)	Stormwater (651)	Campground (660)	Total
\$ 244,538	\$ -	\$ 259,842	\$ 1,264,316
-	-	-	676,491
-	1,833,284	1,467,358	17,450,009
-	332	-	29,794
57	15,434	1,620	1,382,923
-	2,065	1,001	44,601
-	-	-	395,364
-	-	-	1,165,406
807,517	-	-	907,643
<u>1,052,112</u>	<u>1,851,115</u>	<u>1,729,821</u>	<u>23,316,547</u>
-	-	-	4,040,235
6,794,981	1,284,446	2,792,402	100,683,517
-	254,723	35,421	926,221
<u>6,794,981</u>	<u>1,539,169</u>	<u>2,827,823</u>	<u>101,609,738</u>
<u>(432,531)</u>	<u>(485,799)</u>	<u>(1,158,069)</u>	<u>(30,571,779)</u>
6,362,450	1,053,370	1,669,754	71,037,959
<u>6,362,450</u>	<u>1,053,370</u>	<u>1,669,754</u>	<u>75,078,194</u>
7,414,562	2,904,485	3,399,575	98,394,741
30,710	-	645	168,574
16,467	-	558	109,427
<u>47,177</u>	<u>-</u>	<u>1,203</u>	<u>278,001</u>
<u>\$ 7,461,739</u>	<u>\$ 2,904,485</u>	<u>\$ 3,400,778</u>	<u>\$ 98,672,742</u>
\$ 147,349	\$ 5,501	\$ 990	\$ 1,217,601
-	9,512	-	382,009
24,613	-	-	129,433
76,896	12,599	819	199,246
(508)	368	146,613	1,701,097
-	395,364	-	395,364
-	-	-	83,857
-	-	-	3,620
20,370	45,000	5,000	1,311,272
<u>268,720</u>	<u>468,344</u>	<u>153,422</u>	<u>5,423,499</u>
128,135	-	-	875,288
-	-	-	18,112,823
4,003,303	-	36,932	4,040,235
169,311	-	5,736	1,125,104
127,562	-	2,678	700,228
-	718,823	61,148	790,484
<u>(20,370)</u>	<u>(45,000)</u>	<u>(5,000)</u>	<u>(1,311,272)</u>
<u>4,407,941</u>	<u>673,823</u>	<u>101,494</u>	<u>24,332,890</u>
4,676,661	1,142,167	254,916	29,756,389
91,456	-	1,920	502,030
6,362,450	334,547	1,608,606	51,762,155
-	-	-	676,491
<u>(3,668,828)</u>	<u>1,427,771</u>	<u>1,535,336</u>	<u>15,975,677</u>
<u>2,693,622</u>	<u>1,762,318</u>	<u>3,143,942</u>	<u>68,414,323</u>
<u>\$ 7,461,739</u>	<u>\$ 2,904,485</u>	<u>\$ 3,400,778</u>	<u>\$ 98,672,742</u>

City of Two Harbors
Statement of Revenues, Expenses, and Changes
in Fund Net Position - Proprietary Funds
Year Ended December 31, 2025

	Water (601)	Sewer (602)	Electric (604)	Gas (605)
Sales and Cost of Sales				
Sales	\$ -	\$ -	\$ 3,953,838	\$ 2,856,128
Cost of sales	-	-	2,131,778	2,205,883
Gross profit	-	-	1,822,060	650,245
Operating Revenues				
Charges for services	1,337,755	1,457,283	-	-
Penalties	9,224	9,901	26,381	12,172
Other services	5,727	16,524	5,183	91,628
Total operating revenues	1,352,706	1,483,708	31,564	103,800
Operating Expenses				
Wages, salaries, and compensation	342,594	512,748	433,816	402,717
Employee benefits	177,938	161,818	165,696	100,861
Materials and supplies	156,908	121,606	200,577	85,482
Professional services	27,608	188,683	40,111	13,328
Insurance	21,313	57,025	15,522	4,752
Utilities	91,913	220,730	16,056	10,231
Depreciation	728,908	1,482,143	142,338	37,821
Travel and training	3,371	4,698	9,262	4,498
Miscellaneous	15,982	94,063	209,295	70,140
Dues and subscriptions	17,959	24,133	40,387	31,815
Rentals	21	396	2,533	285
Total operating expenses	1,584,515	2,868,043	1,275,593	761,930
Operating income (loss)	(231,809)	(1,384,335)	578,031	(7,885)
Nonoperating Revenues (Expenses)				
Investment income	30,826	223,862	566,538	120,660
Interest expense	(145,153)	(158,304)	(2,652)	(892)
Miscellaneous revenue	-	-	63,083	-
Total nonoperating revenues (expenses)	(114,327)	65,558	626,969	119,768
Income (loss) before transfers	(346,136)	(1,318,777)	1,205,000	111,883
Capital Contributions - Intergovernmental	376,786	1,338,151	-	-
Gain (loss) on disposal of capital assets	-	(38)	-	-
Transfers in	416,850	300,000	-	-
Transfers out	(2,352)	-	(557,244)	(175,440)
Change in net position	445,148	319,336	647,756	(63,557)
Net Position				
Beginning of year, as previously stated	13,082,627	31,428,113	13,036,894	2,006,124
Prior period restatement (Note 13)	-	-	-	(88,000)
Beginning of year, restated	13,082,627	31,428,113	13,036,894	1,918,124
End of year	\$ 13,527,775	\$ 31,747,449	\$ 13,684,650	\$ 1,854,567

See notes to basic financial statements.

<u>Municipal Liquor (609)</u>	<u>Stormwater (651)</u>	<u>Campground (660)</u>	<u>Total</u>
\$ 3,850,078	\$ -	\$ 69,789	\$ 10,729,833
2,436,063	-	50,881	6,824,605
<u>1,414,015</u>	<u>-</u>	<u>18,908</u>	<u>3,905,228</u>
-	160,175	922,678	3,877,891
-	-	-	57,678
-	-	38,641	157,703
<u>-</u>	<u>160,175</u>	<u>961,319</u>	<u>4,093,272</u>
403,779	-	21,863	2,117,517
122,009	75	(10,553)	717,844
34,436	12,661	76,201	687,871
9,520	16,725	122,299	418,274
19,130	1,184	7,517	126,443
12,367	910	44,817	397,024
213,351	38,388	80,817	2,723,766
139	583	-	22,551
298,570	478	62,913	751,441
5,382	-	3,023	122,699
-	45	-	3,280
<u>1,118,683</u>	<u>71,049</u>	<u>408,897</u>	<u>8,088,710</u>
295,332	89,126	571,330	(90,210)
1,711	57,205	70,808	1,071,610
-	(24,087)	(2,777)	(333,865)
-	-	6,477	69,560
<u>1,711</u>	<u>33,118</u>	<u>74,508</u>	<u>807,305</u>
297,043	122,244	645,838	717,095
-	-	-	1,714,937
-	-	-	(38)
-	-	-	716,850
<u>(1,374)</u>	<u>-</u>	<u>(450,000)</u>	<u>(1,186,410)</u>
295,669	122,244	195,838	1,962,434
2,397,953	1,640,074	2,948,104	66,539,889
<u>-</u>	<u>-</u>	<u>-</u>	<u>(88,000)</u>
<u>2,397,953</u>	<u>1,640,074</u>	<u>2,948,104</u>	<u>66,451,889</u>
<u>\$ 2,693,622</u>	<u>\$ 1,762,318</u>	<u>\$ 3,143,942</u>	<u>\$ 68,414,323</u>

City of Two Harbors
Statement of Cash Flows - Proprietary Funds
Year Ended December 31, 2025

	Water (601)	Sewer (602)	Electric (604)	Gas (605)
Cash Flows - Operating Activities				
Receipts from customers and users	\$ 1,338,110	\$ 4,249,621	\$ 4,135,415	\$ 2,915,596
Payments to suppliers	(490,182)	(1,211,160)	(2,666,594)	(2,329,069)
Payments to employees	(616,781)	(738,681)	(634,680)	(583,126)
Net cash flows - operating activities	<u>231,147</u>	<u>2,299,780</u>	<u>834,141</u>	<u>3,401</u>
Cash Flows - Noncapital Financing Activities				
Transfer to other funds	(2,352)	-	(557,244)	(175,440)
Transfer from other funds	416,850	300,000	-	-
Interfund balances	-	(546,394)	370,019	-
State grants and aid	-	-	-	(88,000)
Miscellaneous revenue	-	-	63,083	-
Net cash flows - noncapital financing activities	<u>414,498</u>	<u>(246,394)</u>	<u>(124,142)</u>	<u>(263,440)</u>
Cash Flows - Capital and Related Financing Activities				
Principal paid on debt	(350,321)	20,633	-	-
Interest paid on debt	(144,945)	(153,466)	(7,992)	(892)
Capital contributions	-	-	-	-
Interfund balances	-	-	-	-
Intergovernmental	376,786	1,443,964	-	-
Proceeds from disposal of capital assets	-	(38)	-	-
Acquisition of capital assets	(777,641)	(2,315,067)	(338,275)	(145,810)
Net cash flows - capital and related financing activities	<u>(896,121)</u>	<u>(1,003,974)</u>	<u>(346,267)</u>	<u>(146,702)</u>
Cash Flows - Investing Activities				
Net maturity (purchase) of investments	650,000	(1,141,660)	(969,747)	241,338
Interest and dividends received	32,128	230,308	572,927	122,799
Net cash flows - investing activities	<u>682,128</u>	<u>(911,352)</u>	<u>(396,820)</u>	<u>364,137</u>
Net change in cash and cash equivalents	431,652	138,060	(33,088)	(42,604)
Cash and Cash Equivalents (including restricted amounts)				
January 1	<u>109,663</u>	<u>570,678</u>	<u>157,522</u>	<u>104,544</u>
December 31	<u>\$ 541,315</u>	<u>\$ 708,738</u>	<u>\$ 124,434</u>	<u>\$ 61,940</u>
Reconciliation of Operating Income (Loss) to Net Cash Flows - Operating Activities				
Operating income (loss)	\$ (231,809)	\$ (1,384,335)	\$ 578,031	\$ (7,885)
Adjustments to reconcile operating income (loss) to net cash flows - operating activities				
Depreciation expense	728,908	1,482,143	142,338	37,821
Pension related activity	(57,577)	(75,613)	(51,254)	(64,081)
Unearned revenue	5,791	3,811	15,233	4,627
Accounts receivable	36,826	(85,890)	142,328	(42,483)
Special assessments receivable	(5,791)	(3,811)	(15,233)	(4,627)
Due from other governments	(51,422)	2,851,803	(57)	(40)
Prepaid items	-	-	-	-
Inventory	-	-	(6,001)	6,457
Accounts and contracts payable	(155,107)	(499,826)	4,928	92,120
Customer deposits	-	-	7,742	(1,809)
Due to other governmental units	-	-	-	(1,232)
Salaries payable	(6,469)	2,532	(94)	812
OPEB related activity	(11,456)	(14,089)	(6,970)	(21,100)
Compensated absences payable	(20,747)	23,055	23,150	4,821
Total adjustments	<u>462,956</u>	<u>3,684,115</u>	<u>256,110</u>	<u>11,286</u>
Net cash flows - operating activities	<u>\$ 231,147</u>	<u>\$ 2,299,780</u>	<u>\$ 834,141</u>	<u>\$ 3,401</u>

See notes to basic financial statements.

Municipal Liquor (609)	Stormwater (651)	Campground (660)	Total
\$ 3,849,513	\$ 166,033	\$ 798,464	\$ 17,452,752
(4,087,803)	(30,038)	(376,835)	(11,191,681)
(514,746)	(75)	(24,334)	(3,112,423)
<u>(753,036)</u>	<u>135,920</u>	<u>397,295</u>	<u>3,148,648</u>
(1,374)	-	(450,000)	(1,186,410)
-	-	-	716,850
-	331,690	(73,322)	81,993
-	-	-	(88,000)
-	-	6,477	69,560
<u>(1,374)</u>	<u>331,690</u>	<u>(516,845)</u>	<u>(406,007)</u>
-	(25,000)	(5,000)	(359,688)
76,896	(27,370)	(2,987)	(260,756)
-	-	-	-
(81,993)	-	-	(81,993)
-	-	-	1,820,750
-	-	-	(38)
<u>(80,834)</u>	<u>(120,717)</u>	<u>(35,422)</u>	<u>(3,813,766)</u>
<u>(85,931)</u>	<u>(173,087)</u>	<u>(43,409)</u>	<u>(2,695,491)</u>
300,000	(356,969)	(92,358)	(1,369,396)
1,939	62,446	71,573	1,094,120
<u>301,939</u>	<u>(294,523)</u>	<u>(20,785)</u>	<u>(275,276)</u>
(538,402)	-	(183,744)	(228,126)
782,940	-	443,586	2,168,933
<u>\$ 244,538</u>	<u>\$ -</u>	<u>\$ 259,842</u>	<u>\$ 1,940,807</u>
\$ 295,332	\$ 89,126	\$ 571,330	\$ (90,210)
213,351	38,388	80,817	2,723,766
(5,606)	-	(6,413)	(260,544)
(508)	331	(231,554)	(202,269)
(57)	5,859	(1,090)	55,493
-	(332)	-	(29,794)
-	-	-	2,800,284
4,275	-	-	4,275
(392,503)	-	-	(392,047)
(883,968)	2,548	(9,184)	(1,448,489)
-	-	-	5,933
-	-	-	(1,232)
4,854	-	-	1,635
(6,076)	-	(6,611)	(66,302)
17,870	-	-	48,149
<u>(1,048,368)</u>	<u>46,794</u>	<u>(174,035)</u>	<u>3,238,858</u>
<u>\$ (753,036)</u>	<u>\$ 135,920</u>	<u>\$ 397,295</u>	<u>\$ 3,148,648</u>

**City of Two Harbors
Statement of Fiduciary Net Position
December 31, 2025**

	Recreation Custodial Fund
Assets	
Current	
Cash and investments	\$ 145,652
Interest receivable	147
	\$ 145,799
Liabilities	
Accounts payable	\$ 2,976
Accrued payroll	356
	\$ 3,332
Net Position	
Restricted for recreation	\$ 142,467

**Statement of Changes in Fiduciary Net Position
Year Ended December 31, 2025**

	Recreation Custodial Fund
Additions	
Investment income	\$ 4,006
Other additions	
Contributions	62,800
Miscellaneous	4,273
Charges for services	11,625
Total other additions	78,698
Total additions	82,704
Deductions	
Program expenditures	90,230
Change in net position	(7,526)
Net Position	
Beginning of year	149,993
End of year	\$ 142,467

**City of Two Harbors
Notes to Basic 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 elections are conducted biennially with staggered four-year terms. The Mayor is recognized as the head of the city for all ceremonial purposes and for the service of civil process, but shall have no administrative duty. Powers are provided for the Mayor 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 annually from its members.

3. City Administrator

The City Administrator is appointed by the City Council and shall serve until such time as they resign, retire, or are removed for cause. City Administrator keeps a record of all meetings of the City Council and acts as a custodian of all papers and records of the City.

4. Finance Director

The Finance Director is appointed by the City Council and shall serve an indefinite term unless removed for cause 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 unit. 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 basic 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.

Discretely Presented Component Unit

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 THEDA to emphasize that they are legally separate from the City. THEDA is presented as a governmental fund type.

City of Two Harbors
Notes to Basic Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 fund is 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 Custodial Fund is 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, this Fund is not incorporated into the government-wide statements.

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.

City of Two Harbors
Notes to Basic Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

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 City, except those required to be accounted for in another fund.

Capital Equipment Fund - This fund accounts for resources accumulated and costs associated with the City's equipment.

Street Improvement Capital Projects Fund - This fund accounts for resources accumulated and costs associated with the City's street improvement projects.

G.O. Bond Debt Service Fund - This fund accounts for resources collected and expenditures made to service principal and interest payments on the City's governmental general obligation bonds.

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.

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 Custodial Fund - This fund accounts for the activities sponsored and run by the Recreation Board.

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.

City of Two Harbors
Notes to Basic Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

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.

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 represents 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.

**City of Two Harbors
Notes to Basic Financial Statements**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

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.

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 assets 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 presents deferred outflows of resources on the Statement(s) of Net Position for deferred outflows of resources related to pensions and OPEB for various estimate differences that will be amortized and recognized over future years.

City of Two Harbors
Notes to Basic Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

7. Deferred Outflows/Inflows of Resources (Continued)

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 assets that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time. 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

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.

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.

The liability for compensated absences reported in the Statement of Net Position consists of leave that has not been used that is attributable to services already rendered, accumulates, and is more likely than not to be used for time off or otherwise paid in cash or settled through noncash means. The liability also includes amounts for leave that has been used for time off but has not yet been paid in cash or settled through noncash means and certain other types of leave.

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.

City of Two Harbors
Notes to Basic Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

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 Balance

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 Balances** - These are amounts that cannot be spent because they are not in spendable form.
- **Restricted Fund Balances** - 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 Balances** - 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 Balances** - 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 Balances** - 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 will strive to maintain an unassigned fund balance in the General Fund in the range of 40-50% of the subsequent year's budgeted expenditures.

City of Two Harbors
Notes to Basic Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

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. At December 31, 2025, \$417,036 of the total net position restricted for capital projects related to one cent sales tax collections is restricted due to enabling legislation.

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 non-homesteaded 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 non-homesteaded 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.

City of Two Harbors
Notes to Basic Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

G. Property Tax Collection Calendar (Continued)

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.

H. Right-to-Use Lease Assets/Lease Liabilities

The City is a lessee for numerous noncancellable leases. The right-to-use lease assets are initially measured at an amount equal to the initial measurement of the lease liability plus any payments made prior to the lease term, less lease incentives, and plus ancillary charges necessary to place the lease into service. The right-to-use assets are amortized on a straight-line basis over the life of the related lease. Key estimates and judgments related to leases include (1) the discount rate, (2) lease term, (3) lease payments, and (4) amortization. The City uses the interest rate charged by the lessor as the discount rate. When the interest rate charged by the lessor is not provided, the City determines its estimated borrowing rate based on the applicable State and Local Government Securities rate. The lease term includes the noncancellable period of the lease. Lease payments included in the measurement of the lease liability are composed of fixed payments and purchase option the City is reasonably certain to exercise. The City monitors changes in circumstances that would require a re-measurement of the leases and will remeasure the right-to-use lease assets and liabilities if certain changes occur that are expected to significantly affect the amount of the lease liability.

I. 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.
7. Budgeted amounts are as originally adopted or as amended by the City Council. Budgeted expenditure appropriations lapse at year-end.

City of Two Harbors
Notes to Basic Financial Statements

NOTE 2 - DEPOSITS AND INVESTMENTS

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.

A. Deposits

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, 2025, 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, 2025, the City's deposits consisted of the following:

Checking - pooled	\$ 3,399,876
Checking - non-pooled	5,430
Savings - pooled	47,535
Total Deposits	\$ 3,452,841

B. Investments

Type of Investments	Rating	Fair Value	Investment Maturities			
			Less than 1 year	1-5.01 years	6-10 years	10+ years
Pooled Investments						
Money market	NR	\$ 61,719	\$ 61,719	\$ -	\$ -	\$ -
Certificates of deposit	NR	10,058,079	10,058,079	-	-	-
Total pooled investments		10,119,798	10,119,798	-	-	-
Non-Pooled Investments						
Certificates of deposit	NR	2,187,809	974,619	1,213,190	-	-
Municipal Bonds	AA-	1,449,261	-	569,811	879,450	-
Other gov't backed securities	AA+	13,476,484	-	11,869,192	1,607,292	-
Total non-pooled investments		17,226,720	1,087,785	13,652,193	2,486,742	-
Total investments		\$ 27,346,518	\$ 11,207,583	\$ 13,652,193	\$ 2,486,742	\$ -

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.

City of Two Harbors
Notes to Basic Financial Statements

NOTE 2 - DEPOSITS AND INVESTMENTS (CONTINUED)

B. Investments (Continued)

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: 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.

The City has the following reoccurring fair value measurements as of December 31, 2025:

- \$174,885 are valued using a quoted market price (Level 1 inputs)
- \$27,171,633 of investments are valued using a matrix pricing model (Level 2 inputs)

The following is a summary of total deposits and investments:

Deposits - pooled	\$ 3,447,411
Deposits - non-pooled	5,430
Petty cash	4,200
Investments - pooled	10,119,798
Investments - non-pooled	<u>17,226,720</u>
 Total cash and investments	 <u><u>\$ 30,803,559</u></u>

**City of Two Harbors
Notes to Basic Financial Statements**

NOTE 2 - DEPOSITS AND INVESTMENTS (CONTINUED)

B. Investments (Continued)

Deposits and investments are presented in the December 31, 2025, basic financial statements as follows:

Statement of Net Position

Cash and investments	
Primary government	\$ 29,886,796
Component units	
Two Harbors Economic Development Authority	94,620
Restricted cash	
Primary government	676,491

Statement of Fiduciary Net Position

Cash and investments	145,652
Total	\$ 30,803,559

NOTE 3 - INTERFUND ACTIVITY

A. Transfers

Transfers among funds were for the City to assist with administrative costs, to cover capital expenditures, to assist with capital projects, and assist with debt service obligations.

	Transfers In							Total
	General	Capital Equipment	Street Improvement	G.O. Debt Service	Other Governmental	Water	Sewer	
Transfers Out								
General	\$ -	\$ 63,000	\$ -	\$ -	\$ 358,550	\$ -	\$ -	\$ 421,550
Other governmental funds	624	21,300	-	360,000	-	416,850	300,000	1,098,774
Water	2,352	-	-	-	-	-	-	2,352
Electric	332,244	125,000	-	-	100,000	-	-	557,244
Gas	125,440	50,000	-	-	-	-	-	175,440
Municipal liquor	1,374	-	-	-	-	-	-	1,374
Campground	150,000	150,000	150,000	-	-	-	-	450,000
Total	\$ 612,034	\$ 409,300	\$ 150,000	\$ 360,000	\$ 458,550	\$ 416,850	\$ 300,000	\$ 2,706,734

Transfers among funds were for the City to assist with administrative costs, to cover capital expenditures, to assist with capital projects, and assist with debt service obligations.

**City of Two Harbors
Notes to Basic Financial Statements**

NOTE 3 - INTERFUND ACTIVITY (CONTINUED)

B. Interfund Balances

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

<u>Fund</u>	<u>Due from Other Funds</u>	<u>Due to Other Funds</u>
Capital Equipment	\$ -	\$ 44,204
Other governmental	-	117,279
Water	161,483	-
Stormwater	-	395,364
Liquor	395,364	-
Total	<u>\$ 556,847</u>	<u>\$ 556,847</u>

The following balances arise from interfund borrowings for capital purposes.

<u>Fund</u>	<u>Maturity</u>	<u>Rate</u>	<u>Advance from</u>	<u>Advance to</u>
Electric			\$ 4,040,235	\$ -
Liquor	8/1/2039	2.31%	-	4,003,303
Campground	5/16/2026	0.50%	-	36,932
Total			<u>\$ 4,040,235</u>	<u>\$ 4,040,235</u>

NOTE 4 - NOTES RECEIVABLE

Notes receivable at December 31, 2025, are as follows:

Daniel and Kirsten Cruikshank Note	
\$200,000 loan, due in monthly installments of various amounts through April 2034, interest at 3.0%	<u>\$ 143,588</u>
Total notes receivable	<u>\$ 143,588</u>

City of Two Harbors
Notes to Basic Financial Statements

NOTE 5 - CAPITAL ASSETS

Capital asset activity for the year ended December 31, 2025, was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Governmental activities				
Capital assets not being depreciated/ amortized				
Land	\$ 616,081	\$ -	\$ -	\$ 616,081
Inexhaustible asset	281,528	-	-	281,528
Construction in progress	3,986,098	4,427,889	2,654,758	5,759,229
Total capital assets not being depreciated/amortized	<u>4,883,707</u>	<u>4,427,889</u>	<u>2,654,758</u>	<u>6,656,838</u>
Capital assets being depreciated/ amortized				
Buildings	6,151,178	1,532,612	69,531	7,614,259
Improvements	19,173,826	284,650	-	19,458,476
Structures	311,156	-	-	311,156
Lease machinery and equipment	152,505	-	-	152,505
Machinery and equipment	7,384,332	1,357,400	560,149	8,181,583
Total capital assets being depreciated	<u>33,172,997</u>	<u>3,174,662</u>	<u>629,680</u>	<u>35,717,979</u>
Less accumulated depreciation/ amortization for				
Buildings	3,559,943	198,630	63,960	3,694,613
Improvements	10,550,805	597,564	-	11,148,369
Structures	147,276	9,784	-	157,060
Lease machinery and equipment	88,720	46,770	-	135,490
Machinery and equipment	4,570,690	522,003	495,652	4,597,041
Total accumulated depreciation/amortization	<u>18,917,434</u>	<u>1,374,751</u>	<u>559,612</u>	<u>19,732,573</u>
Governmental activities capital assets, being depreciated/ amortized, net	<u>14,255,563</u>	<u>1,799,911</u>	<u>70,068</u>	<u>15,985,406</u>
Governmental activities capital assets, net	<u>\$ 19,139,270</u>	<u>\$ 6,227,800</u>	<u>\$ 2,724,826</u>	<u>\$ 22,642,244</u>

City of Two Harbors
Notes to Basic Financial Statements

NOTE 5 - CAPITAL ASSETS (CONTINUED)

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

General government	\$ 31,439
Public safety	262,168
Public works	579,857
Culture and recreation	137,054
Health and welfare	11,044
Airport	353,189
Total depreciation/amortization expense - governmental activities	\$ 1,374,751

	Beginning Balance	Increases	Decreases	Ending Balance
Business-type activities				
Capital assets not being depreciated				
Land	\$ 1,890,248	\$ -	\$ -	\$ 1,890,248
Construction in progress	422,371	3,110,594	2,606,744	926,221
Total capital assets not being depreciated	2,312,619	3,110,594	2,606,744	2,816,469
Capital assets being depreciated				
Buildings	64,903,880	2,606,743	-	67,510,623
Structures and improvements	27,451,991	-	-	27,451,991
Machinery and equipment	3,571,367	259,288	-	3,830,655
Total capital assets being depreciated	95,927,238	2,866,031	-	98,793,269
Less accumulated depreciated for				
Buildings	11,790,570	1,896,934	-	13,687,504
Structures and improvements	12,982,517	668,085	-	13,650,602
Machinery and equipment	3,074,928	158,745	-	3,233,673
Total accumulated depreciation	27,848,015	2,723,764	-	30,571,779
Business-type activities capital assets, being depreciated, net	68,079,223	142,267	-	68,221,490
Business-type activities capital assets, net	\$ 70,391,842	\$ 3,252,861	\$ 2,606,744	\$ 71,037,959

City of Two Harbors
Notes to Basic Financial Statements

NOTE 5 - CAPITAL ASSETS (CONTINUED)

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

Water	\$ 728,908
Sewer	1,482,143
Electric	142,338
Gas	37,821
Liquor	213,351
Storm water	38,388
Campground	<u>80,815</u>
 Total depreciation expense - business-type activities	 <u><u>\$ 2,723,764</u></u>

City of Two Harbors
Notes to Basic Financial Statements

NOTE 6 - LONG-TERM DEBT

A. Components of Long-Term Liabilities

	Issue Date	Interest Rates	Original Issue	Final Maturity	Principal Outstanding	Due Within One Year
Primary government						
Long-term liabilities						
Governmental activities						
G.O. Bond 2018A	07/17/18	3.00%	\$ 1,680,000	02/01/34	\$ 1,105,000	\$ 110,000
G.O. Bond 2019B	07/24/19	3.00%	1,825,000	02/01/35	1,305,000	115,000
G.O. Bond 2021A	07/01/21	1.00-2.00%	2,645,000	02/01/37	2,170,000	165,000
G.O. Equipment Certificate 2021B	07/01/21	1.25-2.00%	715,000	02/01/29	415,000	100,000
G.O. Bond 2024A	05/30/24	4.00-5.00%	3,885,000	02/01/40	3,885,000	180,000
G.O. Bond 2024B	05/30/24	4.00-5.00%	1,265,000	02/01/32	1,265,000	155,000
Unamortized premium					575,092	-
Lease liability					15,569	4,948
Compensated absences					1,055,419	259,465
Total governmental activities					11,791,080	1,089,413
Business-type activities						
Notes from direct borrowing,						
including refunding notes						
G.O. PFA Water Revenue Note, 2009	12/14/09	2.53%	2,387,496	08/20/29	531,000	128,000
G.O. PFA Water Revenue Note, 2010	05/11/10	1.67%	2,262,255	08/20/29	532,000	130,000
G.O. PFA Sewer Revenue Note, 2015	10/13/14	1.00%	122,152	08/20/29	31,000	7,600
G.O. PFA Water Revenue Note, 2015	08/06/15	1.00%	4,741,091	08/20/35	2,530,000	242,000
G.O. PFA Sewer Revenue Note, 2018	11/15/19	1.00%	1,825,938	08/20/38	1,279,000	93,000
G.O. PFA Sewer Revenue Note, 2022	07/28/22	1.58%	10,068,299	08/20/38	9,777,531	318,000
G.O. PFA Water Revenue Note, 2023	11/30/23	2.10%	3,365,974	08/20/43	3,432,292	152,000
Total notes from direct borrowing					18,112,823	1,070,600
General obligation bonds						
G.O. Bond 2018A Stormwater	07/17/18	3.00%	280,000	02/01/34	190,000	20,000
G.O. Bond 2018A Electric	07/17/18	3.00%	40,000	02/01/27	10,000	5,000
G.O. Bond 2018 Campground	07/17/18	3.00%	90,000	02/01/34	60,000	5,000
G.O. Bond 2019 Stormwater	07/24/19	3.00%	100,000	02/01/35	75,000	5,000
G.O. Bond 2021A Stormwater	07/01/21	1.00-2.00%	130,000	02/01/37	115,000	5,000
G.O. Bond 2024A Stormwater	05/30/24	4.00-5.00%	300,000	02/01/40	300,000	15,000
Total general obligation bonds					750,000	55,000
Unamortized bond premium					40,483	-
Compensated absences					875,289	185,672
Total business-type					19,778,595	1,311,272
Total all long-term liabilities					\$ 31,569,675	\$ 2,400,685

Long-term indebtedness listed above was issued to finance acquisition and construction of capital facilities or to refinance (refund) previous bond and note issues. The General, Library, and Golf Funds and each enterprise fund liquidate their individual compensated absence liabilities.

City of Two Harbors
Notes to Basic Financial Statements

NOTE 6 - LONG-TERM DEBT (CONTINUED)

B. Changes in Long-Term Liabilities

The Water, Sewer, Stormwater, Electric and Campground Funds are each responsible for the repayment of the corresponding G.O. Notes from direct borrowing.

Long-term liability activity for the year ended December 31, 2025, was as follows:

	Beginning Balance	Additions	Maturities	Ending Balance	Due Within One Year
Governmental activities					
Long-term liabilities					
G.O. Equipment Certificate	\$ 515,000	\$ -	\$ 100,000	\$ 415,000	\$ 100,000
G.O. Bonds	10,105,000	-	375,000	9,730,000	725,000
Unamortized bond premium	622,381	-	47,289	575,092	-
Lease liability	61,525	-	45,956	15,569	4,948
Compensated absences	862,173	323,116	129,870	1,055,419	259,465
Total governmental activities	<u>12,166,079</u>	<u>323,116</u>	<u>698,115</u>	<u>11,791,080</u>	<u>1,089,413</u>
Business-type activities					
Long-term liabilities					
Notes from direct borrowing	18,442,512	720,911	1,050,600	18,112,823	1,070,600
G.O. Bonds	785,000	-	35,000	750,000	55,000
Unamortized bond premium	43,896	-	3,413	40,483	-
Compensated absences	827,139	170,692	122,542	875,289	185,672
Total business-type activities	<u>20,098,547</u>	<u>891,603</u>	<u>1,211,555</u>	<u>19,778,595</u>	<u>1,311,272</u>
Total all long-term liabilities	<u>\$ 32,264,626</u>	<u>\$ 1,214,719</u>	<u>\$ 1,909,670</u>	<u>\$ 31,569,675</u>	<u>\$ 2,400,685</u>

C. Maturity Schedules

Maturity schedules above present future obligations based on projected draws through the completion of related capital projects. Debt schedules in the Components of Long-Term Liabilities and Changes in Long-Term Liabilities sections present draws and liabilities as of December 31, 2025.

City of Two Harbors
Notes to Basic Financial Statements

NOTE 6 - LONG-TERM DEBT (CONTINUED)

D. Lease Liability

The City has entered into various lease agreements for machinery and equipment. Scheduled debt service payments are included in the maturity schedules above. The discount rates used to calculate the lease liability ranges from 3-5%. The lease agreements mature in October of 2028.

Year Ending December 31,	Governmental Activities			
	G.O. Bond and Certificate		Lease Liability	
	Principal	Interest	Principal	Interest
2026	\$ 825,000	\$ 341,239	\$ 4,948	\$ 977
2027	855,000	311,133	5,186	749
2028	885,000	280,720	5,435	511
2029	915,000	249,633	-	-
203	840,000	218,951	-	-
2031-2035	3,825,000	678,694	-	-
2036-2040	2,000,000	178,549	-	-
Total	<u>\$ 10,145,000</u>	<u>\$ 2,258,918</u>	<u>\$ 15,569</u>	<u>\$ 2,237</u>

Year Ending December 31,	Business-Type Activities			
	Notes from Direct Borrowing		G.O. Bond	
	Principal	Interest	Principal	Interest
2026	\$ 1,070,600	\$ 335,507	\$ 55,000	\$ 25,799
2027	1,087,700	327,902	60,000	23,549
2028	1,106,800	307,231	55,000	21,474
2029	1,123,900	286,412	55,000	19,624
2030	856,000	265,242	55,000	17,774
2031-2035	4,492,000	1,080,960	325,000	55,289
2036-2040	3,298,000	688,401	145,000	13,285
2041-2045	2,705,292	355,424	-	-
2046-2050	2,242,000	144,324	-	-
2051-2055	130,531	7,417	-	-
Total	<u>\$ 18,112,823</u>	<u>\$ 3,798,820</u>	<u>\$ 750,000</u>	<u>\$ 176,793</u>

City of Two Harbors
Notes to Basic Financial Statements

NOTE 7 - 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, 2025, the following issues were outstanding:

Name	Date of Issue	Original Amount of Issue	Outstanding as of 12/31/24
Lake View Memorial Hospital Helath Care Facilities Revenue Bond	2019	\$ 6,000,000	\$ 5,308,053

City of Two Harbors
Notes to Basic Financial Statements

NOTE 8 - FUND BALANCE AND NET POSITION

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

	General	G.O Bond Debt Service	Street Improvement Fund	Capital Equipment Fund	Other Governmental Funds	Total
Nonspendable						
Inventory	\$ -	\$ -	\$ -	\$ -	\$ 28,140	\$ 28,140
Total nonspendable	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>28,140</u>	<u>28,140</u>
Restricted						
Revolving loans	-	-	-	-	43,515	43,515
Sales tax appropriations	-	-	-	-	1,756,223	1,756,223
Cemetery endowment	-	-	-	-	156,432	156,432
Bond debt service	-	704,959	-	-	-	704,959
Public Safety Grant	158,894	-	-	-	-	158,894
Gertude Freeman Trust	20,000	-	-	-	-	20,000
Total restricted	<u>178,894</u>	<u>704,959</u>	<u>-</u>	<u>-</u>	<u>1,956,170</u>	<u>2,840,023</u>
Committed						
Golf	-	-	-	-	361,983	361,983
Airport	-	-	-	-	152,662	152,662
Library	-	-	-	-	273,529	273,529
Total committed	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>788,174</u>	<u>788,174</u>
Assigned						
Drug and Alcohol Forfeiture	20,722	-	-	-	-	20,722
Police Donations	615	-	-	-	-	615
Street Improvement Fund	-	-	730,468	-	-	730,468
Capital Equipment Fund	-	-	-	473,451	-	473,451
Capital Projects	-	-	-	-	1,522,955	1,522,955
Total assigned	<u>21,337</u>	<u>-</u>	<u>730,468</u>	<u>473,451</u>	<u>1,522,955</u>	<u>2,748,211</u>
Unassigned	<u>4,440,133</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>4,440,133</u>
Total	<u>\$ 4,640,364</u>	<u>\$ 704,959</u>	<u>\$ 730,468</u>	<u>\$ 473,451</u>	<u>\$ 4,295,439</u>	<u>\$ 10,844,681</u>

The Sewer Fund had an amount restricted of \$676,491 as municipalities receiving Water Infrastructure Fund (WIF) resources must annually deposit a minimum of 50 cents per 1,000 gallons of flow for major rehabilitation, expansion or replacement of the treatment system at the end of its useful life.

NOTE 9 - 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.

City of Two Harbors
Notes to Basic Financial Statements

NOTE 9 - RISK MANAGEMENT (CONTINUED)

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 2025 was estimated to be immaterial based on workers' compensation rates and salaries for the year.

At December 31, 2025, 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 10 - PENSION PLANS

The City participates in various pension plans, total pension expense for the year ended December 31, 2025, was \$280,865. The components of pension expense are noted in the following plan summaries.

The General Fund, Water Utility Fund, Sewer Utility Fund, Electric Utility Fund, Gas Utility Fund, Liquor Fund, and Campground Fund typically liquidate the liability related to pensions.

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 353D, 353E, 353G, and 356. *Minnesota Statutes* Chapter 356 defines each plan's financial reporting requirements. PERA's defined benefit pension plans are tax qualified plans under Section 401(a) of the Internal Revenue Code.

General Employees Retirement Plan

Membership in the General Plan includes employees of counties, cities, townships, schools in non-certified positions, and other governmental entities whose revenues are derived from taxation, fees, or assessments. Plan membership is required for any employee who is expected to earn more than \$425 in a month, unless the employee meets exclusion criteria.

Public Employees Police and Fire Plan

Membership in the Police and Fire Plan includes full-time, licensed police officers and firefighters who meet the membership criteria defined in *Minnesota Statutes* § 353.64 and who are not earning service credit in any other PERA retirement plan or a local relief association for the same service. Employers can provide Police and Fire Plan coverage for part-time positions and certain other public safety positions by submitting a resolution adopted by the City's governing body. The resolution must state that the position meets plan requirements.

City of Two Harbors
Notes to Basic Financial Statements

NOTE 10 - PENSION PLANS (CONTINUED)

Public Employees' Retirement Association (Continued)

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. 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. When a member is vested, they have earned enough service credit to receive a lifetime monthly benefit after leaving public service and reaching an eligible retirement age. Members who retire at or over their Social Security full retirement age with at least one year of service qualify for a retirement benefit.

General Employees Plan Benefits

General Employees Plan requires three years of service to vest. Benefits are based on a member's highest average salary for any 5 successive years of allowable service, age, and years of credit at termination of service. Two methods are used to compute benefits for General Plan members. Members hired prior to July 1, 1989, receive the higher of Step or Level formulas. Only the Level formula is used for members hired after June 30, 1989. Under the Step formula, General Plan members receive 1.2% of the highest average salary for each of the first 10 years of service and 1.7% for each additional year. Under the Level formula, General Plan members receive 1.7% of the highest average salary for all years of service. For members hired prior to July 1, 1989, a full retirement benefit is available when age plus years of service equal 90 and normal retirement age is 65. Members can receive a reduced requirement benefit as early as age 55 if they have three or more years of service. Early retirement benefits are reduced by .25% for each month under age 65. Members with 30 or more years of service can retire at any age with a reduction of .25% for each month the member is younger than age 62. The Level formula allows General Plan members to receive a full retirement benefit at age 65 if they were first hired before July 1, 1989 or at age 66 if they were hired on or after July 1, 1989. Early retirement begins at age 55 with an actuarial reduction applied to the benefit.

Benefit increases are provided to benefit recipients each January. The postretirement increase is equal to 50% of the cost-of-living adjustment (COLA) announced by the SSA, with a minimum increase of at least 1% and a maximum of 1.5%. The 2025 annual increase was 1.25%. Recipients that have been receiving the annuity or benefit for at least a full year as of the June 30 before the effective date of the increase will receive the full increase. Recipients receiving the annuity or benefit for at least one month but less than a full year as of the June 30 before the effective date of the increase will receive a reduced prorated increase. In 2023, legislation repealed the statute delaying increases for members retiring before full retirement age.

Police and Fire Plan Benefits

Benefits for the Police and Fire Plan members first hired before July 1, 2010, are vested after three years of service. Members hired on or after July 1, 2010, are 50% vested after five years of service and 100% vested after 10 years. After five years, vesting increase by 10% each full year of service until members are 100% vested after 10 years. Police and Fire Plan members receive 3% of highest average salary for all years of service. Police and Fire Plan members receive a full retirement benefit when they are 55 and vested, or when their age plus their years of service equals 90 or greater if they were first hired before July 1, 1989. Early retirement starts at age 50, and early retirement benefits are reduced by 0.417% each month members are younger than age 55.

**City of Two Harbors
Notes to Basic Financial Statements**

NOTE 10 - PENSION PLANS (CONTINUED)

Public Employees' Retirement Association (Continued)

B. Benefits Provided (continued)

Police and Fire Plan Benefits (Continued)

Benefit increases are provided to benefit recipients each January. The postretirement increase is fixed at 1%. Recipients that have been receiving the annuity or benefit for at least 36 months as of the June 30 before the effective date of the increase will receive the full increase. Recipients receiving the annuity or benefit for at least 25 months but less than 36 months as of the June 30 before the effective date of the increase will receive a reduced prorated increase.

C. Contributions

Minnesota Statutes Chapter 353, 353E, 353G, and 356 set the rates for employer and employee contributions. Contribution rates can only be modified by the state Legislature.

General Employees Fund Contributions

General Plan members were required to contribute 6.5% of their annual covered salary in fiscal year 2025 and the City was required to contribute 7.5% for General Plan members. The City's contributions to the General Employees Plan for the year ended December 31, 2025, were \$258,105. The City's contributions were equal to the required contributions as set by state statute.

Police and Fire Plan Contributions

Police and Fire Plan members were required to contribute 11.8% of their annual covered salary in fiscal year 2025 and the City was required to contribute 17.7% for Police and Fire Plan members. The City's contributions to the Police and Fire Plan for the year ended December 31, 2025, were \$160,278. The City's contributions were equal to the required contributions as set by state statute.

D. Pension Costs

General Employees Fund Pension Costs

At December 31, 2025, the City reported a liability of \$1,208,121 for its proportionate share of the General Employees Fund's net pension liability. The City's net pension liability reflected a reduction due to the State of Minnesota's contribution of \$16 million. 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 \$29,144.

**City of Two Harbors
Notes to Basic Financial Statements**

NOTE 10 - PENSION PLANS (CONTINUED)

Public Employees' Retirement Association (Continued)

D. Pension Costs (Continued)

General Employees Fund Pension Costs (Continued)

The net pension liability was measured as of June 30, 2025, 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 proportionate share 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, 2024, through June 30, 2025, relative to the total employer contributions received from all of PERA's participating employers. The City's proportionate share was 0.0365% at the end of the measurement period and 0.0358% for the beginning of the period.

City's proportionate share of the net pension liability	\$ 1,208,121
State of Minnesota's proportionate share of the net pension liability associated with the City	<u>29,144</u>
Total	<u><u>\$ 1,237,265</u></u>

For the year ended December 31, 2025, the City recognized pension expense of (\$138,146) for its proportionate share of General Employees Plan's pension expense. Included in the amount, the City recognized (\$4,470) as pension expense (and grant revenue) for its proportionate share of the State of Minnesota's contribution of \$16 million to the General Employees Fund.

At December 31, 2025, 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	\$ 114,778	\$ -
Changes in actuarial assumptions	29,108	283,736
Net difference between projected and actual investment earnings	-	436,880
Changes in proportion	17,907	145,548
Contributions paid to PERA subsequent to the measurement date	<u>129,052</u>	<u>-</u>
Total	<u><u>\$ 290,845</u></u>	<u><u>\$ 866,164</u></u>

**City of Two Harbors
Notes to Basic Financial Statements**

NOTE 10 - PENSION PLANS (CONTINUED)

Public Employees' Retirement Association (Continued)

D. Pension Costs (Continued)

General Employees Fund Pension Costs (Continued)

The \$129,052 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, 1899. 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
2026	\$ (210,426)
2027	(250,278)
2028	(157,792)
2029	(85,875)
Total	\$ (704,371)

Police and Fire Plan Pension Costs

At December 31, 2025, the City reported a liability of \$702,109 for its proportionate share of the Police and Fire Plan's net pension liability. The net pension liability was measured as of June 30, 2025, 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 proportionate share 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, 1899, through June 30, 2025, relative to the total employer contributions received from all of PERA's participating employers. The City's proportionate share was 0.0599% at the end of the measurement period and 0.0515% for the beginning of the period.

**City of Two Harbors
Notes to Basic Financial Statements**

NOTE 10 - PENSION PLANS (CONTINUED)

Public Employees' Retirement Association (Continued)

D. Pension Costs (Continued)

Police and Fire Plan Pension Costs (Continued)

The State of Minnesota contributed \$18 million to the Police and Fire Fund in the plan fiscal year ended June 30, 2025. The contribution consisted of \$9 million in direct state aid that meets the definition of a special funding situation and \$9 million in supplemental state aid that does not meet the definition of a special funding situation. The \$9 million direct state aid was paid on October 1, 2024. The direct state aid payment will increase by \$17.7 million, which was paid on October 1, 2025. Thereafter, by October 1 of each year, the State will pay \$26.7 million to the Police and Fire Fund until the fund is 110% funded for a minimum of three consecutive years (on an actuarial value of assets basis). The \$9 million in supplemental state aid will continue until the fund and the State Patrol Plan (administered by the Minnesota State Retirement System) are 100% funded for three consecutive years (on an actuarial value of assets basis). The State of Minnesota's proportionate share of the net pension liability associated with the City totaled \$24,339.

City's proportionate share of the net pension liability	\$ 702,109
State of Minnesota's proportionate share of the net pension liability associated with the City	24,339
Total	\$ 726,448

For the year ended December 31, 2025, the City recognized pension expense of \$208,434 for its proportionate share of the Police and Fire Plan's pension expense. Included in this amount, the City recognized \$11,776 as pension expense (and grant revenue) for its proportionate share of the State of Minnesota's contribution of \$9 million to the Police and Fire Fund.

**City of Two Harbors
Notes to Basic Financial Statements**

NOTE 10 - PENSION PLANS (CONTINUED)

Public Employees' Retirement Association (Continued)

D. Pension Costs (Continued)

Police and Fire Plan Pension Costs (Continued)

At December 31, 2025, 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	\$ 301,123	\$ -
Changes in actuarial assumptions	474,228	812,669
Net difference between projected and actual investment earnings	-	299,106
Changes in proportion	133,498	44,366
Contributions paid to PERA subsequent to the measurement date	80,139	-
Total	\$ 988,988	\$ 1,156,141

The \$80,139 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, 2026. 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
2026	\$ 155,042
2027	(129,245)
2028	(295,627)
2029	(14,225)
2030	36,763
Total	\$ (247,292)

**City of Two Harbors
Notes to Basic Financial Statements**

NOTE 10 - PENSION PLANS (CONTINUED)

Public Employees' Retirement Association (Continued)

E. Long-Term Expected Return on Investment

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 equity	33.5 %	5.10 %
International equity	16.5	5.30
Fixed income	25.0	0.75
Private markets	25.0	5.90
Total	100.0 %	

F. Actuarial Methods and Assumptions

The total pension liability for each of the cost-sharing defined benefit plans was determined by an actuarial valuation as of June 30, 2025, using the entry-age normal actuarial cost method. The long-term rate of return on pension plan investments used to determine the total liability is 7.0%. The 7.0% assumption is based on a review of inflation and investments return assumptions from a number of national investment consulting firms. The review provided a range of investment return rates considered reasonable by the actuary. An investment return of 7.0% is within that range.

Inflation is assumed to be 2.25% for the General Employees Plan and 2.25% for the Police and Fire Plan. Benefit increases after retirement are assumed to be 1.5% for the General Employees Plan and 1% for the Police and Fire Plan.

Salary growth assumptions in the General Employees Plan range in annual increments from 11.5% after one year of service to 3.0% after 27 years of service. In the Police and Fire Plan, salary growth assumptions range in annual increments from 10.75% after one year of service to 3.0% after 23 years of service.

Mortality rates for the General Employees Plan are based on the Pub-2010 General Employee Mortality Table. Mortality rates for the Police and Fire Plan are based on the Pub-2010 Public Safety Employee Mortality tables. The tables are adjusted slightly to fit PERA's experience.

City of Two Harbors
Notes to Basic Financial Statements

NOTE 10 - PENSION PLANS (CONTINUED)

Public Employees' Retirement Association (Continued)

F. Actuarial Methods and Assumptions (Continued)

Actuarial assumptions for the General Employees Plan are reviewed every four years. The General Employees Plan was last reviewed in 2022. The assumption changes were adopted by the Board and became effective with the July 1, 2023, actuarial valuation. The Police and Fire Plan was reviewed in 2024. The assumption changes were adopted by the board and became effective with the July 1, 2025, actuarial valuation.

The following changes in actuarial assumptions and plan provisions occurred in 2025:

General Employees Fund

Changes in Actuarial Assumptions

- The combined service annuity loading factors increased from 15% to 19% for vested terminated members and from 3% to 44% for non-vested, terminated members. The assumed post-retirement benefit increase changed from 1.25% to 1.5%.

Changes in Plan Provisions

- The post-retirement benefit increase formula changed to 100% of the Social Security annual increase, between 1% and 1.75% , beginning January 1, 2026. If the funded ratio (on a market value of assets basis) is less than 85% for the last two consecutive annual valuations or is less than 80% in the most recent actuarial valuation, the maximum is reduced to 1.5%. Previously, the benefit increase was 50% of the Social Security annual increase, between 1% and 1.5%.
- The 1% additional employer contribution is eliminated when the plan reaches 98% funded status (on an actuarial value of assets basis); this contribution was previously scheduled to stop when the plan reached 100% funded status.

Police and Fire Fund

Changes in Actuarial Assumptions

- Assumed rates of salary increases were reduced slightly.
- Assumed rates of retirement were adjusted, resulting in an overall increase in unreduced (full) retirements and an overall increase in reduced (early) retirements.
- Assumed rates of withdrawal were modified; the new rates will increase predicted terminations, especially in the first few years of employment.
- Assumed rates of disabled retirement were significantly increased, especially for ages over age 30.
- Continued use of Pub-2010 Public Safety Mortality Table with rates adjusted to better fit observed experience.
- Percent married assumption for female retirees lowered from 70% to 65%.
- Minor changes were made to form of payment assumptions for retirees.
- Minor changes were made to assumptions made with respect to missing participant data.
- The combined service annuity load changed from 33% to 13% for vested, terminated members and from 2% to 38% for non-vested, terminated members.

**City of Two Harbors
Notes to Basic Financial Statements**

NOTE 10 - PENSION PLANS (CONTINUED)

Public Employees' Retirement Association (Continued)

F. Actuarial Methods and Assumptions (Continued)

Police and Fire Fund (Continued)

Changes in Plan Provisions

- The period of time needed for benefit recipients to receive their first benefit increase was reduced by one year (from 36 months to 24 months for a full increase).
- The January 1, 2026, benefit increase changed from 1% to 3%; subsequent January 1 increases will be 1%.
- The threshold to end the \$9 million annual state aid contribution changed from the earlier of July 1, 2048, or 90% funded for both PERA Police & Fire and MSRS State Patrol for three consecutive years to 100% funded for both PERA Police and Fire and MSRS State Patrol for three consecutive years (on an actuarial value of assets basis).
- The threshold to end the additional \$9 million annual state aid contribution changed from the earlier of July 1, 2048 or 100% funded for a minimum of three consecutive years to 110% funded for a minimum of three consecutive years (on an actuarial value of assets basis).
- An additional \$17.7 million in direct state aid will be paid annually each October 1 beginning October 1, 2025, through June 30, 2048.
- Join and survivor actuarial equivalent factors were updated to reflect changes in assumptions.

G. Discount Rate

The discount rate used for the General Employees Plan used to measure the total pension liability in 2025 was 7.0%. 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 these assumptions, the fiduciary net positions of the General Employees and Police and Fire Plans were 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.

H. Pension Liability Sensitivity

The following 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 (6.0%)	Current Discount Rate (7.0%)	1% Increase in Discount Rate (8.0%)
City's proportionate share of the General Employees Fund net pension liability	\$ 2,934,340	\$ 1,208,121	\$ (192,228)

**City of Two Harbors
Notes to Basic Financial Statements**

NOTE 10 - PENSION PLANS (CONTINUED)

Public Employees' Retirement Association (Continued)

H. Pension Liability Sensitivity (Continued)

	1% Decrease in Discount Rate (6.0%)	Current Discount Rate (7.0%)	1% Increase in Discount Rate (8.0%)
City's proportionate share of the Police and Fire Fund net pension liability	\$ 1,839,670	\$ 702,109	\$ (232,011)

I. 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 Firefighter'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*.

Defined Benefit Pension Plan - Volunteer Firefighter's Relief Association

A. Plan Description (Continued)

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.

B. Benefits Provided

Volunteer firefighters of the City are members of the Two Harbors Firefighter's Relief Association. Full retirement benefits are payable to members who have reached age 50 and have completed 20 years of service for monthly service pension. Partial benefits are payable to members who have reached 50 and have completed 5 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.

**City of Two Harbors
Notes to Basic Financial Statements**

NOTE 10 - PENSION PLANS (CONTINUED)

Defined Benefit Pension Plan - Volunteer Firefighter's Relief Association (Continued)

C. Employees Covered by Benefit Terms

At December 31, 2024, the following employees were covered by the benefit terms:

Inactive employees or beneficiaries currently receiving benefits	8
Inactive employees entitled to but not yet receiving benefits	0
Active employees	24
Total	32

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 \$89,041 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, 1899, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date.

Actuarial Assumptions

The total pension liability in the December 31, 1899, actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	2.50%
Salary increase	N/A%, average, including inflation
Investment rate of return	5.75%, 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.

**City of Two Harbors
Notes to Basic Financial Statements**

NOTE 10 - PENSION PLANS (CONTINUED)

Defined Benefit Pension Plan - Volunteer Firefighter's Relief Association (Continued)

E. Net Pension Liability (Continued)

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.

<u>Asset Class</u>	<u>Target Allocation</u>	<u>Long-Term Expected Real Rate of Return</u>
Cash	14.0 %	0.84 %
Fixed income	40.0	2.27
Equities	44.0	5.65
Other	2.0	4.44
Total	<u>100.0 %</u>	

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.

City of Two Harbors
Notes to Basic Financial Statements

NOTE 10 - PENSION PLANS (CONTINUED)

Defined Benefit Pension Plan - Volunteer Firefighter's Relief Association (Continued)

F. Changes in the Net Pension Liability

	Increase (Decrease)		
	Total Pension Liability (a)	Plan Fiduciary Net Position (b)	Net Pension Liability (a) - (b)
	(a)	(b)	(a) - (b)
Balances at January 1, 2024	\$ 888,115	\$ 1,103,485	\$ (215,370)
Changes for the year			
Service cost	55,386	-	55,386
Interest cost	54,111	-	54,111
Differences between expected and actual experience	(42,368)	-	(42,368)
Changes of assumptions	(32,579)	-	(32,579)
Changes of benefit terms	187,112	-	187,112
State contributions	-	81,383	(81,383)
Net investment income	-	172,550	(172,550)
Other additions	-	257	(257)
Benefit payments	(4,877)	(4,877)	-
Administrative expense	-	(20,000)	20,000
Net changes	<u>216,785</u>	<u>229,313</u>	<u>(12,528)</u>
Balances at December 31, 2024	<u>\$ 1,104,900</u>	<u>\$ 1,332,798</u>	<u>\$ (227,898)</u>

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:

	1% Decrease in Discount Rate 3.08%	Current Discount Rate 4.08%	1% Increase in Discount Rate 5.08%
City's net pension liability (asset)	<u>\$ (188,880)</u>	<u>\$ (227,898)</u>	<u>\$ (265,553)</u>

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.

**City of Two Harbors
Notes to Basic Financial Statements**

NOTE 10 - PENSION PLANS (CONTINUED)

Defined Benefit Pension Plan - Volunteer Firefighter'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, 2025, the City recognized pension expense of \$209,033. At December 31, 2025, 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	\$ 100	\$ 82,789
Changes of assumptions	13,398	30,250
Net collective difference between projected and actual earnings on pension plan investments	-	76,640
City's contributions to relief association subsequent to measurement date	89,041	-
Total	\$ 102,539	\$ 189,679

The \$89,041 reported as deferred outflows of resources related 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, 1899. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as shown below.

Year Ending December 31,	Total
2026	\$ (24,839)
2027	(10,630)
2028	(58,264)
2029	(35,575)
2030	(12,948)
Thereafter	(33,925)
Total	\$ (176,181)

**City of Two Harbors
Notes to Basic Financial Statements**

NOTE 10 - PENSION PLANS (CONTINUED)

Defined Benefit Pension Plan - Volunteer Firefighter's Relief Association (Continued)

H. Payable to the Pension Plan

At December 31, 2025, the City reported a payable of \$0 for the outstanding amount of contributions to the pension plan required for the year ended December 31, 2025.

NOTE 11 - POST EMPLOYMENT HEALTH CARE PLAN

A. Plan Description

The City's defined benefit OPEB plan provides a single employer defined benefit health care plan to eligible retirees. The plan offers medical coverage. 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. No assets are acclimated in a trust.

B. Benefits Provided

Benefit provisions are established through negotiations between the City and the unions representing the City employees and are renegotiated each bargaining period. Retired employees receive no retiree benefits except the allowance to continue health insurance that is mandated by Minnesota Law. The Retiree Health Plan does not issue a publicly available financial report.

C. Contributions

Retirees contribute to the health care plan at the same rate as City employees. This results in the retirees 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 the year 2025, the City contributed \$202,623 to the plan.

D. Members

As of December 31, 2024, the following were covered by the benefit terms:

Retirees receiving payments	7
Actives waiving coverage	4
Active employees	49
	<hr/>
Total	60
	<hr/> <hr/>

E. Actuarial Assumptions

Since the last valuation, the following actuarial assumption changes have been made:

- The discount rate was changed from 3.77% to 4.08% based on updated 20-year municipal bond rates.

**City of Two Harbors
Notes to Basic Financial Statements**

NOTE 11 - POST EMPLOYMENT HEALTH CARE PLAN (CONTINUED)

E. Actuarial Assumptions (Continued)

The total OPEB liability was determined by an actuarial valuation as of December 31, 2025, using the following actuarial assumptions, applied to all periods included in the measurement, unless otherwise specified:

Key Methods and Assumptions Used in Valuation of Total OPEB Liability

Discount rate	4.08%
Salary increases	3.25%, including inflation
Inflation	2.50%
Healthcare cost trend increases	6.9% for FY2024, gradually decreasing over several decades to an ultimate rate of 3.9% in FY2075 and later years.
Mortality assumption General Employees	From the July 1, 2023 PERA of Minnesota General Employees Retirement Plan actuarial valuation, Pub-2010 General mortality tables with projected mortality improvements based on scale MP-2021, and other adjustments.
Police and Fire	From the July 1, 2023, PERA of Minnesota Public Employees' Police and Fire Plan actuarial valuation, mortality rates were based on the Pub-2010 mortality tables with projected mortality improvements based on scale MP-2021, and other adjustments.

The actuarial assumptions used in the December 31, 2024, valuation was based on the results of an actuarial experience study for the period January 1, 2023 through December 31, 2023.

The discount rate used to measure the total OPEB liability was 4.08% which is equal to the 20 Year Municipal Bond Yield.

**City of Two Harbors
Notes to Basic Financial Statements**

NOTE 11 - POST EMPLOYMENT HEALTH CARE PLAN (CONTINUED)

F. Total OPEB Liability

The City's total OPEB liability of \$2,445,427 was measured as of December 31, 2025, and was determined by an actuarial valuation as of that date.

	Total OPEB Liability
Balances at January 1, 2025	\$ 2,429,747
Changes for the year	
Service cost	197,172
Interest	95,216
Differences between expected and actual economic experience	(23,107)
Changes of assumptions	(50,978)
Change in benefit terms	-
Benefit payments	(202,623)
Net changes	15,680
Balances at December 31, 2025	\$ 2,445,427

The General Fund, Water Utility Fund, Sewer Utility Fund, Electric Utility Fund, Gas Utility Fund, Liquor Utility Fund, and Campground Utility Fund typically liquidate the Liability related to OPEB.

G. OPEB Liability Sensitivity

The following presents the City's total OPEB liability calculated using the discount rate of 4.08% as well as the liability measured using 1% lower and 1% higher than the current discount rate.

Total OPEB Liability		
1% Decrease in Discount Rate (2.77%)	Current Discount Rate (3.77%)	1% Increase in Discount Rate (4.77%)
\$ 2,614,178	\$ 2,445,427	\$ 2,289,087

**City of Two Harbors
Notes to Basic Financial Statements**

NOTE 11 - POST EMPLOYMENT HEALTH CARE PLAN (CONTINUED)

G. OPEB Liability Sensitivity (Continued)

The following presents the total OPEB liability of the City, as well as what the City's total OPEB liability would be if it were calculated using healthcare cost trend rates that are 1% lower and 1% higher than the current healthcare cost trend rates.

Total OPEB Liability		
1% Decrease in Trend Rate (5.9% Decreasing to 2.9%)	Current Trend Rate (6.9% Decreasing to 3.9%)	1% Increase in Trend Rate (7.9% Decreasing to 4.9%)
\$ 2,216,327	\$ 2,445,427	\$ 2,712,375

H. OPEB Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to OPEB

For the year ended December 31, 2025, the City recognized OPEB expense of \$218,302. At December 31, 2025, the City reported deferred outflows of resources and deferred inflows of resources related to OPEB from the following sources:

	Deferred Outflows of Resources
Contributions subsequent to the measurement date	\$ 237,842
Total	\$ 237,842

The \$202,623 reported as deferred outflows of resources related to OPEB resulting from City contributions subsequent to the measurement date will be recognized as a reduction of the total OPEB liability in the year ended December 31, 2025.

NOTE 12 - COMMITMENTS

At December 31, 2025, the City had outstanding construction contract commitments totaling \$1,205,184.

City of Two Harbors
Notes to Basic Financial Statements

NOTE 13 - PRIOR PERIOD RESTATEMENT

For the year ended December 31, 2025, a prior period adjustment was required to adjust beginning net position for the Gas Fund to reflect an overstatement of revenue in 2024. This adjustment affected beginning net position for the Gas Fund and business type activities in the amount of \$88,000.

	Reporting Units Affected by Adjustments to and Restatements of Beginning Balances	
	Funds	Government- Wide
	Gas Fund	Business-Type Activities
12/31/2024, as previously reported	\$ 2,066,124	\$ 66,539,889
Prior Period Restatement	(88,000)	(88,000)
12/31/2024, as adjusted or restated	\$ 1,978,124	\$ 66,451,889

NOTE 14 - NEW STANDARDS ISSUED BUT NOT YET IMPLEMENTED

GASB Statement No. 103, *Financial Reporting Model Improvements*. The changes required by this Statement provide clarity, enhance the relevance of information, provide more useful information for decision-making, and provide for greater comparability amongst government entities. This Statement will be effective for the year ending December 31, 2026.

GASB Statement No. 104, *Disclosure of Certain Capital Assets*. The disclosures required by this Statement provide users of the financial statements with essential information about certain types of capital assets. This Statement will be effective for the year ending December 31, 2026.

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REQUIRED SUPPLEMENTARY INFORMATION

City of Two Harbors
Schedule of Changes in Total OPEB Liability
and Related Ratios

	December 31, 2018	December 31, 2019	December 31, 2020	December 31, 2021
Total OPEB Liability				
Service cost	\$ 143,400	\$ 165,392	\$ 148,693	\$ 207,731
Interest	117,886	108,958	115,598	89,066
Differenced between expected and actual experience	-	-	(250,264)	(76,888)
Changes of assumptions	101,591	(145,722)	271,446	163,514
Changes of benefit terms	-	(76,370)	-	-
Benefit payments	(165,469)	(208,913)	(214,094)	(229,073)
Net change in total OPEB liability	<u>197,408</u>	<u>(156,655)</u>	<u>71,379</u>	<u>154,350</u>
Beginning of year	<u>3,033,443</u>	<u>3,230,851</u>	<u>3,074,196</u>	<u>3,145,575</u>
Total OPEB liability	<u>\$ 3,230,851</u>	<u>\$ 3,074,196</u>	<u>\$ 3,145,575</u>	<u>\$ 3,299,925</u>
Covered-employee payroll	\$ 3,343,369	\$ 3,358,853	\$ 3,338,302	\$ 3,551,708
Total OPEB liability as a percentage of covered-employee payroll	96.63%	91.53%	94.23%	92.91%

Note 1: Schedule is intended to show ten year trend. Additional years will be reported as they become available.

Note 2: There are no assets accumulated in a trust.

December 31, 2022	December 31, 2023	December 31, 2024	December 31, 2025
\$ 247,763	\$ 225,718	\$ 166,864	\$ 197,172
69,591	49,191	96,854	95,216
(791,729)	(7,312)	(162,543)	(23,107)
(198,372)	(380,557)	130,001	(50,978)
-	-	40,919	-
(136,233)	(86,434)	(133,899)	(202,623)
<u>(808,980)</u>	<u>(199,394)</u>	<u>138,196</u>	<u>15,680</u>
<u>3,299,925</u>	<u>2,490,945</u>	<u>2,291,551</u>	<u>2,429,747</u>
<u>\$ 2,490,945</u>	<u>\$ 2,291,551</u>	<u>\$ 2,429,747</u>	<u>\$ 2,445,427</u>
\$ 3,773,609	\$ 3,872,844	\$ 3,694,123	\$ 3,911,939
66.01%	59.17%	65.77%	62.51%

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 (Percentage) of the Net Pension Liability (Asset)	City's Proportionate Share (Amount) of the Net Pension Liability (Asset)	State's Proportionate Share (Amount) of the Net Pension Liability Associated with the City	City's Proportionate Share of the Net Pension Liability and the State's Proportionate Share of the Net Pension Liability Associated with the City	City's Covered Payroll	City's Proportionate Share of the Net Pension Liability (Asset) as a Percentage of its Covered Payroll	Plan Fiduciary Net Position as a Percentage of the Total Pension Liability
2025	0.0365%	\$ 1,208,121	\$ 29,144	\$ 1,237,265	\$ 3,301,773	36.59%	90.78%
2024	0.0358%	1,323,880	34,322	1,358,202	3,030,813	43.68%	89.08%
2023	0.0379%	2,119,326	58,355	2,177,681	3,010,667	70.39%	83.10%
2022	0.0423%	3,350,174	98,352	3,448,526	3,170,040	105.68%	76.67%
2021	0.0402%	1,716,720	52,390	1,769,110	2,893,693	59.33%	87.00%
2020	0.0381%	2,284,269	70,484	2,354,753	2,717,720	84.05%	79.06%
2019	0.0396%	2,189,395	67,997	2,257,392	2,803,400	78.10%	80.23%
2018	0.0425%	2,357,726	77,348	2,435,074	2,857,600	82.51%	79.53%
2017	0.4160%	2,655,717	33,399	2,689,116	2,680,387	99.08%	75.90%
2016	0.0427%	3,467,028	45,325	3,512,353	2,651,853	130.74%	68.91%

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 Proportion of the Net Pension Liability (Asset)	City's Proportionate Share of the Net Pension Liability (Asset)	State's Proportionate Share (Amount) of the Net Pension Liability Associated with the City	City's Proportionate Share of the Net Pension Liability and the State's Proportionate Share of the Net Pension Liability Associated with the City	City's Covered Payroll	City's Proportionate Share of the Net Pension Liability (Asset) as a Percentage of its Covered Payroll	Plan Fiduciary Net Position as a Percentage of the Total Pension Liability
2025	0.0599%	\$ 702,109	\$ 24,339	\$ 726,448	\$ 909,452	79.88%	91.78%
2024	0.0515%	678,086	25,848	703,934	713,718	98.63%	90.17%
2023	0.0533%	954,959	38,448	993,407	703,584	141.19%	86.47%
2022	0.0534%	2,323,757	101,455	2,425,212	648,480	373.98%	70.53%
2021	0.0533%	406,623	18,498	425,121	688,784	61.72%	93.66%
2020	0.0538%	704,300	16,656	720,956	648,796	111.12%	87.19%
2019	0.0504%	529,755	N/A	529,755	544,265	97.33%	89.26%
2018	0.0564%	596,086	N/A	596,086	594,506	100.27%	88.84%
2017	0.0560%	751,027	N/A	751,027	571,259	131.47%	85.43%
2016	0.0560%	2,247,377	N/A	2,247,377	535,309	419.83%	63.88%

**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
2025	\$ 258,105	\$ 258,105	\$ -	\$ 3,441,400	7.50%
2024	236,832	236,832	-	3,157,760	7.50%
2023	227,093	227,093	-	3,027,908	7.50%
2022	231,105	231,105	-	3,081,400	7.50%
2021	231,671	231,671	-	3,088,947	7.50%
2020	216,775	216,775	-	2,890,333	7.50%
2019	203,381	203,381	-	2,711,747	7.50%
2018	214,140	214,140	-	2,855,200	7.50%
2017	207,598	207,598	-	2,767,973	7.50%
2016	201,992	201,992	-	2,693,227	7.50%

**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
2025	\$ 160,278	\$ 160,278	\$ -	\$ 905,525	17.70%
2024	162,411	162,411	-	917,576	17.70%
2023	124,534	124,534	-	703,584	17.70%
2022	125,040	125,040	-	706,441	17.70%
2021	111,762	111,762	-	631,424	17.70%
2020	110,575	110,575	-	624,718	17.70%
2019	94,350	94,350	-	556,637	16.95%
2018	92,168	92,168	-	568,938	16.20%
2017	94,965	94,965	-	586,204	16.20%
2016	90,946	90,946	-	561,395	16.20%

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

	<u>2024</u>	<u>2023</u>	<u>2022</u>	<u>2021</u>
Total Pension Liability (TPL)				
Service cost	\$ 55,386	\$ 54,035	\$ 44,405	\$ 38,951
Interest	54,111	48,493	45,638	37,030
Differenced between expected and actual experience	(42,368)	-	(50,041)	-
Changes of assumptions	(32,579)	-	7,913	-
Changes of benefit terms	187,112	-	71,223	68,192
Benefit payments, including refunds of member contributions	(4,877)	(7,454)	(23,800)	-
Net change in total pension liability	<u>216,785</u>	<u>95,074</u>	<u>95,338</u>	<u>144,173</u>
Beginning of year	<u>888,115</u>	<u>793,041</u>	<u>697,703</u>	<u>553,530</u>
End of year	<u>\$ 1,104,900</u>	<u>\$ 888,115</u>	<u>\$ 793,041</u>	<u>\$ 697,703</u>
Plan Fiduciary Net Position (FNP)				
Contributions - employer	\$ 81,383	\$ 69,312	\$ 65,381	\$ 56,297
Contributions - donations and other income	-	-	-	-
Net investment income	172,550	166,329	(172,996)	125,630
Other additions	257	719	-	-
Benefit payments, including refunds of member contributions	(4,877)	(7,454)	(23,800)	-
Administrative expense	(20,000)	(11,210)	(3,915)	(11,000)
Other	-	-	-	-
Net change in plan fiduciary net position	<u>229,313</u>	<u>217,696</u>	<u>(135,330)</u>	<u>170,927</u>
Beginning of year	<u>1,103,485</u>	<u>885,789</u>	<u>1,021,119</u>	<u>850,192</u>
End of year	<u>\$ 1,332,798</u>	<u>\$ 1,103,485</u>	<u>\$ 885,789</u>	<u>\$ 1,021,119</u>
Net Pension Liability (NPL)	<u>\$ (227,898)</u>	<u>\$ (215,370)</u>	<u>\$ (92,748)</u>	<u>\$ (323,416)</u>
Plan fiduciary net position as a percentage of the total pension liability	120.6%	124.3%	111.7%	146.4%
Covered employee payroll	N/A	N/A	N/A	N/A
Net pension liability as a percentage of covered payroll	N/A	N/A	N/A	N/A

See notes to required supplementary information.

2020	2019	2018	2017	2016	2015
\$ 48,016	\$ 45,661	\$ 38,632	\$ 33,804	\$ 47,135	\$ 35,852
35,762	40,824	45,480	38,996	37,453	34,576
(18,145)	-	373	-	(45,192)	-
4,846	-	8,027	44,345	(21,800)	48,442
-	17,326	-	-	-	36,986
(82,250)	(292,075)	-	-	(155,812)	(78,417)
(11,771)	(188,264)	92,512	117,145	(138,216)	77,439
565,301	753,565	661,053	543,908	682,124	604,685
<u>\$ 553,530</u>	<u>\$ 565,301</u>	<u>\$ 753,565</u>	<u>\$ 661,053</u>	<u>\$ 543,908</u>	<u>\$ 682,124</u>
\$ 54,105	\$ 54,279	\$ 49,569	\$ 61,045	\$ 54,261	\$ 51,722
-	-	-	-	(6,390)	6,390
129,763	153,692	(42,741)	112,071	48,110	(1,150)
-	-	-	-	1,201	-
(82,250)	(292,075)	-	-	(155,812)	(78,417)
(7,850)	(9,476)	(5,544)	(7,344)	(7,301)	(7,080)
-	(28)	-	-	-	(200)
93,768	(93,608)	1,284	165,772	(65,931)	(28,735)
756,424	850,032	848,748	682,976	748,907	777,642
<u>\$ 850,192</u>	<u>\$ 756,424</u>	<u>\$ 850,032</u>	<u>\$ 848,748</u>	<u>\$ 682,976</u>	<u>\$ 748,907</u>
<u>\$ (296,662)</u>	<u>\$ (191,123)</u>	<u>\$ (96,467)</u>	<u>\$ (187,695)</u>	<u>\$ (139,068)</u>	<u>\$ (66,783)</u>
153.6%	133.8%	112.8%	128.4%	125.6%	109.8%
N/A	N/A	N/A	N/A	N/A	N/A
N/A	N/A	N/A	N/A	N/A	N/A

See notes to required supplementary information.

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

	<u>2024</u>	<u>2023</u>	<u>2022</u>	<u>2021</u>
Employer				
Statutorily determined contribution (SDC)	\$ -	\$ -	\$ -	\$ -
Contribution made	-	-	-	-
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Non-employer				
2% aid	\$ 78,536	\$ 66,824	\$ 58,074	\$ 56,297

<u>2020</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
-	-	-	(11,500)	(2,300)	(2,300)
<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (11,500)</u>	<u>\$ (2,300)</u>	<u>\$ (2,300)</u>
\$ 53,105	\$ 50,279	\$ 49,569	\$ 49,545	\$ 51,961	\$ 49,422

City of Two Harbors
Notes to Required Supplementary Information

General Employees Fund

2025 Changes

Changes in Actuarial Assumptions

- The combined service annuity loading factors increased from 15% to 19% for vested, terminated members and from 3% to 44% for non-vested, terminated members.
- The assumed post-retirement benefit increase changed from 1.25% to 1.5%.

Changes in Plan Provisions

- The post-retirement benefit increase formula changed to 100% of the Social Security annual increase, between 1% and 1.75%, beginning January 1, 2026. If the funded ratio (on a market value of assets basis) is less than 85% for the last two consecutive annual valuations or is less than 80% in the most recent actuarial valuation, the maximum is reduced to 1.5%. Previously, the benefit increase was 50% of the Social Security annual increase, between 1% and 1.5%.
- The 1% additional employer contribution is eliminated when the plan reaches 98% funded status (on an actuarial value of assets basis); this contribution was previously scheduled to stop when the plan reached 100% funded status.

2024 Changes

Changes in Actuarial Assumptions

- Rates of merit and seniority were adjusted, resulting in slightly higher rates.
- Assumed rates of retirement were adjusted as follows: increase the rate of assumed unreduced retirements, slight adjustments to Rule of 90 retirement rates, and slight adjustments to early retirement rates for Tier 1 and Tier 2 members.
- Minor increase in assumed withdrawals for males and females.
- Lower rates of disability.
- Continued use of Pub-2010 general mortality table with slight rate adjustments as recommended in the most recent experience study.
- Minor changes to form of payment assumptions for male and female retirees.
- Minor changes to assumptions made with respect to missing participant data.

Changes in Plan Provisions

- The workers' compensation offset for disability benefits was eliminated. The actuarial equivalent factors updated to reflect the changes in assumptions.

2023 Changes

Changes in Actuarial Assumptions

- The investment return assumption and single discount rate were changed from 6.5% to 7.0%.

Changes in Plan Provisions

- An additional one-time direct state aid contribution of \$170.1 million was contributed to the Plan on October 1, 2023.
- The vesting period of those hired after June 30, 2010, was changed from five years of allowable service to three years of allowable service.
- The benefit increase delay for early retirements on or after January 1, 2024, was eliminated.
- A one-time, non-compounding benefit increase of 2.5% minus the actual 2024 adjustment will be payable in a lump sum for calendar year 2024 by March 31, 2024.

City of Two Harbors
Notes to Required Supplementary Information

General Employees Fund (Continued)

2022 Changes

Changes in Actuarial Assumptions

- The mortality improvement scale was changed from scale MP-2020 to scale MP-2021.

Changes in Plan Provisions

- There have been no changes since the prior valuation.

2021 Changes

Changes in Actuarial Assumptions

- The investment return and single discount rates were changed from 7.5% to 6.5% for financial reporting purposes.
- The mortality improvement scale was changed from scale MP-2019 to scale MP-2020.

Changes in Plan Provisions

- There have been no changes since the prior valuation.

2020 Changes

Changes in Actuarial Assumptions

- The price inflation assumption was decreased from 2.5% to 2.25%.
- The payroll growth assumption was decreased from 3.25% to 3.0%.
- Assumed salary increase rates were changed as recommended in the June 30, 2019, experience study. The net effect is assumed rates that average 0.25% less than previous rates.
- Assumed rates of retirement were changed as recommended in the June 30, 2019, experience study. The changes result in more unreduced (normal) retirements and slightly fewer Rule of 90 and early retirements.
- Assumed rates of termination were changed as recommended in the June 30, 2019, experience study. The new rates are based on service and are generally lower than the previous rates for years 2-5 and slightly higher thereafter.
- Assumed rates of disability were changed as recommended in the June 30, 2019, experience study. The change results in fewer predicted disability retirements for males and females.
- The base mortality table for healthy annuitants and employees was changed from the RP-2014 table to the Pub-2010 General Mortality table, with adjustments. The base mortality table for disabled annuitants was changed from the RP-2014 disabled annuitant mortality table to the Pub-2010 General/Teacher disabled annuitant mortality table, with adjustments.
- The mortality improvement scale was changed from Scale MP-2018 to Scale MP-2019.
- The assumed spouse age difference was changed from two years older for females to one year older.
- The assumed number of married male new retirees electing the 100% Joint and Survivor option changed from 35% to 45%. The assumed number of married female new retirees electing the 100% Joint and Survivor option changed from 15% to 30%. The corresponding number of married new retirees electing the Life annuity option was adjusted accordingly.

Changes in Plan Provisions

- Augmentation for current privatized members was reduced to 2.0% for the period July 1, 2020, through December 31, 2023, and 0.0% thereafter. Augmentation was eliminated for privatizations occurring after June 30, 2020.

City of Two Harbors
Notes to Required Supplementary Information

General Employees Fund (Continued)

2019 Changes

Changes in Actuarial Assumptions

- The mortality projection scale was changed from MP-2017 to MP-2018.

Changes in Plan Provisions

- The employer supplemental contribution was changed prospectively, decreasing from \$31.0 million to \$21.0 million per year. The State's special funding contribution was changed prospectively, requiring \$16.0 million due per year through 2031.

2018 Changes

Changes in Actuarial Assumptions

- The mortality projection scale was changed from MP-2015 to MP-2017.
- The assumed benefit increase was changed from 1.0% per year through 2044 and 2.5% per year thereafter to 1.25% per year.

Changes in Plan Provisions

- The augmentation adjustment in early retirement factors is eliminated over a five-year period starting July 1, 2019, resulting in actuarial equivalence after June 30, 2024.
- Interest credited on member contributions decreased from 4.00% to 3.00%, beginning July 1, 2018.
- Deferred augmentation was changed to 0.00%, effective January 1, 2019. Augmentation that has already accrued for deferred members will still apply.
- Contribution stabilizer provisions were repealed.
- Annual increases were changed from 1.00% per year with a provision to increase to 2.50% upon attainment of 90.00% funding ratio to 50.00% of the Social Security Cost of Living Adjustment, not less than 1.00% and not more than 1.50%, beginning January 1, 2019.
- For retirements on or after January 1, 2024, the first benefit increase is delayed until the retiree reaches normal retirement age. This does not apply to Rule of 90 retirees, disability benefit recipients, or survivors.
- Actuarial equivalent factors were updated to reflect revised mortality and interest assumptions.

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 annual 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.

Changes in Plan Provisions

- The State's contribution for the Minneapolis Employees Retirement Fund equals \$16,000,000 in 2017 and 2018, and \$6,000,000 thereafter.
- The Employer Supplemental Contribution for the Minneapolis Employees Retirement Fund changed from \$21,000,000 to \$31,000,000 in calendar years 2019 to 2031. The State's contribution changed from \$16,000,000 to \$6,000,000 in calendar years 2019 to 2031.

City of Two Harbors
Notes to Required Supplementary Information

General Employees Fund (Continued)

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 was decreased by 0.25% to 3.25% for payroll growth and 2.50% for inflation.

Changes in Plan Provisions

- There have been no changes since the prior valuation.

City of Two Harbors
Notes to Required Supplementary Information

Police and Fire Fund

2025 Changes

Changes in Actuarial Assumptions

- Assumed rates of salary increases were reduced slightly.
- Assumed rates of retirement were adjusted, resulting in an overall increase in unreduced (full) retirements and an overall increase in reduced (early) retirements.
- Assumed rates of withdrawal were modified; the new rates will increase predicted terminations, especially in the first few years of employment.
- Assumed rates of disabled retirement were significantly increased, especially for ages over age 30.
- Continued use of Pub-2010 Public Safety Mortality Table with rates adjusted to better fit observed experience.
- Percent married assumption for female retirees lowered from 70% to 65%.
- Minor changes were made to form of payment assumptions for retirees.
- Minor changes were made to assumptions made with respect to missing participant data.
- The combined service annuity load changed from 33% to 13% for vested, terminated members and from 2% to 38% for non-vested, terminated members.

Changes in Plan Provisions

- The period of time needed for benefit recipients to receive their first benefit increase was reduced by one year (from 36 months to 24 months for a full increase).
- The January 1, 2026, benefit increase changed from 1% to 3%; subsequent January 1 increases will be 1%.
- The threshold to end the \$9 million annual state aid contribution changed from the earlier of July 1, 2048, or 90% funded for both PERA Police & Fire and MSRS State Patrol for three consecutive years to 100% funded for both PERA Police & Fire and MSRS State Patrol for three consecutive years (on an actuarial value of assets basis).
- The threshold to end the additional \$9 million annual state aid contribution changed from the earlier of July 1, 2048 or 100% funded for a minimum of three consecutive years to 110% funded for a minimum of three consecutive years (on an actuarial value of assets basis).
- An additional \$17.7 million in direct state aid will be paid annually each October 1 beginning October 1, 2025, through June 30, 2048.
- Joint and survivor actuarial equivalent factors were updated to reflect changes in assumptions.

2024 Changes

Changes in Plan Provisions

- The State contribution of \$9.0 million per year will continue until the earlier of 1) both the Police and Fire Plan and the State Patrol Retirement Fund attain 90% funded status for three consecutive years (on an actuarial value of assets basis) or 2) July 1, 2048. The contribution was previously due to expire after attaining a 90% funded status for one year.
- The additional \$9.0 million contribution will continue until the Police and Fire Plan is fully funded for a minimum of three consecutive years on an actuarial value of assets basis, or July 1, 2048, whichever is earlier. This contribution was previously due to expiration upon attainment of fully funded status on an actuarial value of assets basis for one year (or July 1, 2048 if earlier).

City of Two Harbors
Notes to Required Supplementary Information

Police and Fire Fund (Continued)

2023 Changes

Changes in Actuarial Assumptions

- The investment return assumption was changed from 6.5% to 7.0%.
- The single discount rate changed from 5.4% to 7.0%.

Changes in Plan Provisions

- Additional one-time direct state aid contribution of 19.4 million will be contributed to the Plan on October 1, 2023.
- Vesting requirement for new hires after June 30, 2014, was changed from a graded 20-year vesting schedule to a graded 10-year vesting schedule, with 50% vesting after five years, increasing incrementally to 100% after 10 years.
- A one-time, non-compounding benefit increase of 3.0% will be payable in a lump sum for calendar year 2024 by March 31, 2024.
- Psychological treatment is required effective July 1, 2023, prior to approval for a duty disability benefit for a psychological condition relating to the member's occupation.
- The total and permanent duty disability benefit was increased, effective July 1, 2023.

2022 Changes

Changes in Actuarial Assumptions

- The mortality improvement scale was changed from scale MP-2020 to scale MP-2021.
- The single discount rate was changed from 6.5% to 5.4%.

Changes in Plan Provisions

- There have been no changes since the prior valuation.

2021 Changes

Changes in Actuarial Assumptions

- The investment return and single discount rates were changed from 7.5% to 6.5% for financial reporting purposes.
- The inflation assumption was changed from 2.5% to 2.25%.
- The payroll growth assumption was changed from 3.25% to 3.0%.
- The base mortality table for healthy annuitants and employees was changed from the RP-2014 table to the Pub-2010 Public Safety mortality table. The mortality improvement scale was changed from MP-2019 to MP-2020.
- The base mortality table for disabled annuitants was changed from the RP-2014 healthy annuitant mortality table (with future mortality improvement according to scale MP-2019) to the Pub-2010 Public Safety disabled annuitant mortality table (with future mortality improvement according to scale MP-2020).
- Assumed rates of salary increase were modified as recommended in the July 14, 2020, experience study. The overall impact is a decrease in gross salary increase rates.
- Assumed rates of retirement were changed as recommended in the July 14, 2020, experience study. The changes resulted in slightly more unreduced retirements and fewer assumed early retirements.
- Assumed rates of withdrawal were changed from select and ultimate rates to service-based rates. The changes resulted in more assumed terminations.
- Assumed rates of disability were increased for ages 25-44 and decreased for ages over 49. Overall, proposed rates resulted in more projected disabilities.

City of Two Harbors
Notes to Required Supplementary Information

Police and Fire Fund (Continued)

2021 Changes (Continued)

Changes in Actuarial Assumptions (Continued)

- Assumed percent married for active female members was changed from 60% to 70%. Minor changes to form of payment assumptions were applied.

Changes in Plan Provisions

- There have been no changes since the prior valuation.

2020 Changes

Changes in Actuarial Assumptions

- The mortality projection scale was changed from MP-2018 to MP-2019.

Changes in Plan Provisions

- There have been no changes since the prior valuation.

2019 Changes

Changes in Actuarial Assumptions

- The mortality projection scale was changed from MP-2017 to MP-2018.

Changes in Plan Provisions

- There have been no changes since the prior valuation.

2018 Changes

Changes in Actuarial Assumptions

- The mortality projection scale was changed from MP-2016 to MP-2017.

Changes in Plan Provisions

- Annual increases were changed to 1.00% for all years, with no trigger.
- An end date of July 1, 2048, was added to the existing \$9.0 million state contribution.
- New annual state aid will equal \$4.5 million in fiscal years 2019 and 2020, and \$9.0 million thereafter until the plan reaches 100% funding, or July 1, 2048, if earlier.
- Member contributions were changed from 10.80% to 11.30% of pay, effective January 1, 2019, and 11.80% of pay, effective January 1, 2020.
- Employer contributions were changed from 16.20% to 16.95% of pay, effective January 1, 2019, and 17.70% of pay, effective January 1, 2020.

Changes in Plan Provisions (Continued)

- Interest credited on member contributions decreased from 4.00% to 3.00%, beginning July 1, 2018.
- Deferred augmentation was changed to 0.00%, effective January 1, 2019. Augmentation that has already accrued for deferred members will still apply.
- Actuarial equivalent factors were updated to reflect revised mortality and interest assumptions.

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 three years younger) and female members (husbands assumed to be four years older) to the assumption that males are two 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.
- The single discount rate was changed from 5.6% per annum to 7.5% per annum.

Changes in Plan Provisions

- There have been no changes since the prior valuation.

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 single discount rate changed from 7.90% to 5.60%.
- The assumed future salary increases, payroll growth, and inflation was decreased by 0.25% to 3.25% for payroll growth and 2.50% for inflation.

Changes in Plan Provisions

- There have been no changes since the prior valuation.

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

Volunteer Firefighter's Relief Association

2025 Changes

- The expected investment return and discount rate decreased from 6.50% to 6.75% to reflect updated capital market assumptions.

2024 Changes

- None

2023 Changes

- The lump sum benefit amount increased from \$4,400 to \$4,900.

2022 Changes

- The lump sum benefit amount increased from \$3,900 to \$4,400.

2021 Changes

- The mortality assumptions were updated from the rates used in the July 1, 2018, Minnesota PERA Police & Fire Plan actuarial valuation to the rates used in the July 1, 2020, Minnesota PERA Police & Fire Plan actuarial valuation.
- The inflation assumption decreased from 2.50% to 2.25%.

2020 Changes

- The lump sum benefit amount increased from \$3,800 to \$3,900.

2019 Changes

- The expected investment return and discount rate decreased from 6.50% to 6.25% to reflect updated capital market assumptions.
- The mortality and withdrawal assumptions were updated from the rates used in the July 1, 2016, Minnesota PERA Police & Fire Plan actuarial valuation to the rates used in the July 1, 2018, Minnesota PERA Police & Fire Plan actuarial valuation.
- The inflation assumption decreased from 2.75% to 2.50%.

City of Two Harbors
Notes to Required Supplementary Information

Post Employment Health Care Plan

2025 Changes

- The discount rate was changed from 3.77% to 4.08% based on updated 20-year municipal bond rates.

2024 Changes

- The discount rate was changed from 4.05% to 3.77% based on updated 20-year municipal bond rates.
- The inflation rate was changed from 3.00% to 2.50%.
- The payroll growth rate changed from 3.00% to 3.25%.

2023 Changes

Changes in Actuarial Assumptions

- The discount rate was changed from 1.84% to 4.05% based on updated 20-year municipal bond rates.
- Health care trend rates were reset to reflect updated cost increase expectations. Medical per capita claims costs were updated to reflect recent experience and new plan offerings.
- Withdrawal, retirement, mortality, and salary increase rates were updated from the rates used in the 7/1/2020 PERA General Employees Plan and 7/1/2020 Police and Fire Plan valuations to the rates used in the 7/1/2022 valuations.
- The percent of future retirees assumed to elect life insurance coverage at retirement changed from 70% to 50% to reflect recent plan experience.
- The percent of future non-Medicare eligible retirees electing each medical plan changed to reflect recent plan experience and new plan offerings.
- The inflation assumption was changed from 2.25% to 2.50% based on an updated historical analysis of inflation rates and forward-looking market expectations.
- The payroll growth assumption was changed from 3.00% to 3.25% based on the 7/1/2022 PERA evaluations.

2022 Changes

Changes in Actuarial Assumptions

- The discount rate was changed from 2.00% to 1.84% based on updated 20-year municipal bond rates.
- Healthcare trend rates were reset to reflect updated cost increase expectations.
- Medical per capita claims costs were updated to reflect recent experience and new plan offerings.
- Withdrawal, mortality, and salary increase rates were updated from the rates used in the 7/1/2019 PERA General Employees Plan and 7/1/2019 PERA Police & Fire Plan valuations to the rates used in the 7/1/2021 valuations.
- The inflation assumptions were changed from 2.50% to 2.25% based on an updated historical analysis of inflation rates and forward-looking market expectations.
- The assumed retirement age for Police employees changed from age 50 to age 55 to reflect updated expectations.

2021 Changes

Changes in Actuarial Assumptions

- The discount rate was changed from 2.75% to 2.00% based on updated 20-year municipal bond rates.

City of Two Harbors
Notes to Required Supplementary Information

Post Employment Health Care Plan (Continued)

2020 Changes

Changes in Plan Provisions

- Retiree premiums were updated to current levels.

Changes in Actuarial Assumptions

- The discount rate was changed from 3.71% to 2.75% based on updated 20-year municipal bond rates.
- Healthcare trend rates were reset to reflect updated cost increase expectations, including the repeal of the Affordable Care Act's Excise Tax on high-cost health insurance plans.
- Medical per capita claims costs were updated to reflect recent experience and new plan offerings, including an adjustment to reflect age/gender-based risk scores published by the Society of Actuaries.
- Withdrawal and salary scale rates were updated from the rates used in the July 1, 2017, PERA of Minnesota General Employees and Police & Fire Retirement Plan actuarial valuations to the rates used in the July 1, 2019, valuations.
- Mortality rates were updated from the RP-2014 headcount-weighted tables to the rates used in the July 1, 2019, PERA of Minnesota General Employees and Police & Fire Retirement Plan actuarial valuations to reflect recently published mortality rates.
- The inflation assumption was changed from 2.75% to 2.50% based on an updated historical analysis of inflation rates and forward-looking market expectations.

2019 Changes

Changes in Actuarial Assumptions

- The discount rate increased from 3.31% to 3.71%.
- The health care trend rates were updated to exclude the Affordable Care Act's Excise Tax on high-cost health insurance plan due to its repeal.

SUPPLEMENTARY INFORMATION

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City of Two Harbors
Schedule of Revenues, Expenditures, and
Changes in Fund Balance -
Budget and Actual - General Fund
Year Ended December 31, 2025

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Over (Under)
	Original	Final		
Revenues				
Taxes				
General property taxes	\$ 2,630,427	\$ 2,630,427	\$ 2,113,425	\$ (517,002)
Cable television franchise tax	22,750	22,750	18,074	(4,676)
Total taxes	<u>2,653,177</u>	<u>2,653,177</u>	<u>2,131,499</u>	<u>(521,678)</u>
Licenses and permits	55,700	55,700	70,990	15,290
Intergovernmental revenues				
State grants and aids				
Local government aid	2,109,975	2,109,975	2,109,975	-
Taconite aid	-	-	315,421	315,421
State grant	-	-	19,448	19,448
State fire aid	63,650	63,650	89,041	25,391
State police aid	85,300	85,300	110,868	25,568
County highway grants	22,258	22,258	23,827	1,569
Other grants and aids	4,850	4,850	175,823	170,973
Total intergovernmental revenues	<u>2,286,033</u>	<u>2,286,033</u>	<u>2,844,403</u>	<u>558,370</u>
Charges for services				
Fire contract	108,450	108,450	178,583	70,133
Cemetery services	33,750	33,750	30,408	(3,342)
Other	35,850	35,850	46,864	11,014
Total charges for services	<u>178,050</u>	<u>178,050</u>	<u>255,855</u>	<u>77,805</u>
Fines and forfeitures	5,600	5,600	5,248	(352)
Miscellaneous revenues				
Investment income	47,200	47,200	139,919	92,719
Other	37,050	37,050	39,812	2,762
Total miscellaneous revenues	<u>84,250</u>	<u>84,250</u>	<u>179,731</u>	<u>95,481</u>
Total revenues	<u>5,262,810</u>	<u>5,262,810</u>	<u>5,487,726</u>	<u>224,916</u>

City of Two Harbors
Schedule of Revenues, Expenditures, and
Changes in Fund Balance -
Budget and Actual - General Fund
Year Ended December 31, 2025

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Over (Under)
	Original	Final		
Expenditures				
General government				
Mayor and council	\$ 88,650	\$ 88,650	\$ 114,277	\$ 25,627
Administrative and finance	560,500	560,500	515,391	(45,109)
Other general government	419,900	419,900	280,412	(139,488)
Total general government	<u>1,069,050</u>	<u>1,069,050</u>	<u>910,080</u>	<u>(158,970)</u>
Public safety				
Police				
Current	1,617,850	1,617,850	1,517,173	(100,677)
Capital outlay	20,000	20,000	-	(20,000)
Total police	<u>1,637,850</u>	<u>1,637,850</u>	<u>1,517,173</u>	<u>(120,677)</u>
Fire				
Current	297,150	297,150	373,839	76,689
Animal control				
Current	12,050	12,050	11,613	(437)
Other				
Current	2,750	2,750	3,054	304
Total public safety	<u>1,949,800</u>	<u>1,949,800</u>	<u>1,905,679</u>	<u>(44,121)</u>
Public works				
Streets and highways				
Street maintenance	1,626,400	1,626,400	1,301,549	(324,851)
Street signs	10,300	10,300	-	(10,300)
Equipment maintenance	90,000	90,000	61,807	(28,193)
Total streets and highways	<u>1,726,700</u>	<u>1,726,700</u>	<u>1,363,356</u>	<u>(363,344)</u>
Sanitation				
Waste removal	51,400	51,400	63,176	11,776
Tree removal	8,000	8,000	13,773	5,773
Total sanitation	<u>59,400</u>	<u>59,400</u>	<u>76,949</u>	<u>17,549</u>
Total public works	<u>1,786,100</u>	<u>1,786,100</u>	<u>1,440,305</u>	<u>(345,795)</u>
Culture and recreation				
Current expenditures	299,400	299,400	348,927	49,527
Total culture and recreation	<u>299,400</u>	<u>299,400</u>	<u>348,927</u>	<u>49,527</u>
Health and welfare				
Cemetery				
Current	147,150	147,150	139,378	(7,772)

City of Two Harbors
Schedule of Revenues, Expenditures, and
Changes in Fund Balance -
Budget and Actual - General Fund
Year Ended December 31, 2025

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Over (Under)
	Original	Final		
Expenditures (Continued)				
Miscellaneous	\$ 201,250	\$ 201,250	\$ 166,841	\$ (34,409)
Total expenditures	<u>5,452,750</u>	<u>5,452,750</u>	<u>4,911,210</u>	<u>(541,540)</u>
Excess of revenues over (under) expenditures	(189,940)	(189,940)	576,516	766,456
Other Financing Sources (Uses)				
Transfers in	612,034	612,034	612,034	-
Transfers out	<u>(421,550)</u>	<u>(421,550)</u>	<u>(421,550)</u>	<u>-</u>
Total other financing sources (uses)	<u>190,484</u>	<u>190,484</u>	<u>190,484</u>	<u>-</u>
Net change in fund balance	<u>\$ 544</u>	<u>\$ 544</u>	767,000	<u>\$ 766,456</u>
Fund Balance				
Beginning of year			<u>3,873,364</u>	
End of year			<u>\$ 4,640,364</u>	

**City of Two Harbors
Combining Balance Sheet -
Nonmajor Governmental Funds
December 31, 2025**

	Special Revenue			
	Library (211)	Airport (231)	Local Sales Tax (261)	Tax Increment Financing (251)
Assets				
Cash and investments	\$ 405,000	\$ 133,827	\$ 340,608	\$ 219,098
Taxes receivable - delinquent	-	-	-	-
Accounts receivable	-	4,620	75,804	-
Interest receivable	836	223	624	144
Due from other governments	-	29,230	-	-
Notes receivable	-	-	-	-
Inventories	-	28,140	-	-
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total assets	<u>\$ 405,836</u>	<u>\$ 196,040</u>	<u>\$ 417,036</u>	<u>\$ 219,242</u>
Liabilities				
Accounts payable	2,244	2,201	-	-
Due to other funds	117,279	-	-	-
Accrued payroll	12,784	115	-	-
Unearned revenue	-	12,922	-	-
Total liabilities	<u>132,307</u>	<u>15,238</u>	<u>-</u>	<u>-</u>
Deferred Inflows of Resources				
Unavailable revenue - property taxes	-	-	-	-
Total deferred inflows of resources	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Fund Balances				
Nonspendable	-	28,140	-	-
Restricted	-	-	417,036	219,242
Committed	273,529	152,662	-	-
Assigned	-	-	-	-
Total fund balances	<u>273,529</u>	<u>180,802</u>	<u>417,036</u>	<u>219,242</u>
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total liabilities, deferred inflows of resources, and fund balances	<u>\$ 405,836</u>	<u>\$ 196,040</u>	<u>\$ 417,036</u>	<u>\$ 219,242</u>

Special Revenue				Permanent
Revolving Loan Fund SCDP (205)	City Sales Tax (263)	Golf (241)	Total	Cemetery Perpetual (810)
\$ 43,486	\$ 1,041,900	\$ 367,810	\$ 2,551,729	\$ 156,417
-	-	-	-	-
-	75,804	-	156,228	-
29	2,241	348	4,445	15
-	-	-	29,230	-
-	-	-	-	-
-	-	-	28,140	-
<u>\$ 43,515</u>	<u>\$ 1,119,945</u>	<u>\$ 368,158</u>	<u>\$ 2,769,772</u>	<u>\$ 156,432</u>
-	-	6,175	10,620	-
-	-	-	117,279	-
-	-	-	12,899	-
-	-	-	12,922	-
-	-	6,175	153,720	-
-	-	-	-	-
-	-	-	-	-
-	-	-	28,140	-
43,515	1,119,945	-	1,799,738	156,432
-	-	361,983	788,174	-
-	-	-	-	-
<u>43,515</u>	<u>1,119,945</u>	<u>361,983</u>	<u>2,616,052</u>	<u>156,432</u>
<u>\$ 43,515</u>	<u>\$ 1,119,945</u>	<u>\$ 368,158</u>	<u>\$ 2,769,772</u>	<u>\$ 156,432</u>

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**City of Two Harbors
Combining Balance Sheet -
Nonmajor Governmental Funds
December 31, 2025**

	Capital Projects			Total Governmental Funds
	Edna G. Restoration Project (411)	Permanent Improvements (500)	Total	
Assets				
Cash and investments	\$ 797,184	\$ 549,488	\$ 1,346,672	\$ 4,054,818
Taxes receivable - delinquent	-	357	357	357
Accounts receivable	14,612	35,009	49,621	205,849
Interest receivable	1,781	1,246	3,027	7,487
Due from other governments	-	42,852	42,852	72,082
Notes receivable	-	143,588	143,588	143,588
Inventories	-	-	-	28,140
	<u>\$ 813,577</u>	<u>\$ 772,540</u>	<u>\$ 1,586,117</u>	<u>\$ 4,512,321</u>
Liabilities				
Accounts payable	14,343	30,428	44,771	55,391
Due to other funds	-	-	-	117,279
Accrued payroll	-	-	-	12,899
Unearned revenue	-	18,034	18,034	30,956
Total liabilities	<u>14,343</u>	<u>48,462</u>	<u>62,805</u>	<u>216,525</u>
Deferred Inflows of Resources				
Unavailable revenue - property taxes	-	357	357	357
Total deferred inflows of resources	<u>-</u>	<u>357</u>	<u>357</u>	<u>357</u>
Fund Balances				
Nonspendable	-	-	-	28,140
Restricted	-	-	-	1,956,170
Committed	-	-	-	788,174
Assigned	799,234	723,721	1,522,955	1,522,955
Total fund balances	<u>799,234</u>	<u>723,721</u>	<u>1,522,955</u>	<u>4,295,439</u>
Total liabilities, deferred inflows of resources, and fund balances	<u>\$ 813,577</u>	<u>\$ 772,540</u>	<u>\$ 1,586,117</u>	<u>\$ 4,512,321</u>

City of Two Harbors
Combining Statement of Revenues, Expenditures, and Changes
in Fund Balances - Nonmajor Governmental Funds
Year Ended December 31, 2025

	Special Revenue			
	Library (211)	Airport (231)	Local Sales Tax (261)	Tax Increment Financing (251)
Revenues				
Taxes	\$ -	\$ -	\$ -	\$ -
Sales tax	-	-	494,814	-
Intergovernmental				
State grants and aid	-	49,284	-	-
County grants and aid	67,520	7,500	-	-
Arrowhead library system	20	-	-	-
Charges for services	4,983	137,546	-	-
Miscellaneous				
Investment income	8,863	3,522	23,531	7,587
Loan payments	-	-	-	-
Total revenues	<u>81,386</u>	<u>197,852</u>	<u>518,345</u>	<u>7,587</u>
Expenditures				
Current				
General government	-	-	-	-
Culture and recreation	375,687	-	-	-
Economic development	-	-	-	109
Airport	-	207,508	-	-
Capital outlay				
Culture and recreation	-	-	-	-
Total expenditures	<u>375,687</u>	<u>207,508</u>	<u>-</u>	<u>109</u>
Excess of revenues over (under) expenditures	(294,301)	(9,656)	518,345	7,478
Other Financing Sources (Uses)				
Transfers in	296,250	37,300	-	-
Transfers out	-	-	(716,850)	-
Total other financing sources (uses)	<u>296,250</u>	<u>37,300</u>	<u>(716,850)</u>	<u>-</u>
Net change in fund balances	1,949	27,644	(198,505)	7,478
Fund Balances				
Beginning of year	<u>271,580</u>	<u>153,158</u>	<u>615,541</u>	<u>211,764</u>
End of year	<u>\$ 273,529</u>	<u>\$ 180,802</u>	<u>\$ 417,036</u>	<u>\$ 219,242</u>

Special Revenue				Permanent
Revolving Loan Fund SCDP (205)	City Sales Tax (263)	Golf (241)	Total	Cemetery Perpetual (810)
\$ -	\$ -	\$ -	\$ -	\$ -
-	494,814	-	989,628	-
-	-	-	49,284	-
-	-	-	75,020	-
-	-	-	20	-
-	-	513,876	656,405	-
1,555	40,313	6,653	92,024	4,406
-	-	-	-	-
<u>1,555</u>	<u>535,127</u>	<u>520,529</u>	<u>1,862,381</u>	<u>4,406</u>
-	-	-	-	-
-	-	559,355	935,042	-
-	-	-	109	-
-	-	-	207,508	-
-	-	-	-	-
-	-	<u>559,355</u>	<u>1,142,659</u>	-
1,555	535,127	(38,826)	719,722	4,406
-	-	125,000	458,550	-
-	(360,000)	(21,300)	(1,098,150)	(624)
-	(360,000)	103,700	(639,600)	(624)
1,555	175,127	64,874	80,122	3,782
41,960	944,818	297,109	2,535,930	152,650
<u>\$ 43,515</u>	<u>\$ 1,119,945</u>	<u>\$ 361,983</u>	<u>\$ 2,616,052</u>	<u>\$ 156,432</u>

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City of Two Harbors
Combining Statement of Revenues, Expenditures, and Changes
in Fund Balances - Nonmajor Governmental Funds
Year Ended December 31, 2025

	Capital Projects			Total Governmental Funds
	Edna G. Restoration Project (411)	Permanent Improvements (500)	Total	
Revenues				
Taxes	\$ -	33,301	\$ 33,301	\$ 33,301
Sales tax	93,024	-	93,024	1,082,652
Intergovernmental				
State grants and aid	-	42,333	42,333	91,617
County grants and aid	-	-	-	75,020
Arrowhead library system	-	694	694	714
Charges for services	-	38,998	38,998	695,403
Miscellaneous				
Investment income	28,683	-	28,683	125,113
Loan payments	-	4,469	4,469	4,469
Total revenues	121,707	119,795	241,502	2,108,289
Expenditures				
Current				
General government	-	99,820	99,820	99,820
Culture and recreation	-	-	-	935,042
Economic development	-	-	-	109
Airport	-	-	-	207,508
Capital outlay				
Culture and recreation	14,382	-	14,382	14,382
Total expenditures	14,382	99,820	114,202	1,256,861
Excess of revenues over (under) expenditures	107,325	19,975	127,300	851,428
Other Financing Sources (Uses)				
Transfers in	-	-	-	458,550
Transfers out	-	-	-	(1,098,774)
Total other financing sources (uses)	-	-	-	(640,224)
Net change in fund balances	107,325	19,975	127,300	211,204
Fund Balances				
Beginning of year	691,909	703,746	1,395,655	4,084,235
End of year	\$ 799,234	\$ 723,721	\$ 1,522,955	\$ 4,295,439

City of Two Harbors
Balance Sheet - Component Unit -
Two Harbors Economic Development Authority
December 31, 2025

Assets

Cash and investments	\$ 94,620
Interest receivable	<u>62</u>
Total assets	<u><u>\$ 94,682</u></u>

Fund Balance

Committed	<u>\$ 94,682</u>
Total fund balances	<u>94,682</u>
Total liabilities and Fund balances	<u><u>\$ 94,682</u></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, 2025

Revenues

Investment income	\$ 3,353
Total revenues	<u>3,353</u>

Excess of revenues over (under) expenditures	3,353
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Net change in fund balances	3,353
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Fund Balance

Beginning of year	<u>91,329</u>
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End of year	<u><u>\$ 94,682</u></u>
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City of Two Harbors
Schedule of Expenditures of Federal Awards
Year Ended December 31, 2025

Federal Agency/Pass Through Agency/Program Title	Federal Assistance Listing Number	Expenditures
U.S. Environmental Protection Agency		
State of Minnesota Public Facility Authority		
Capitalization Grants for Clean Water State Revolving Funds - Loan	66.458	\$ 888,461
Capitalization Grants for Clean Water State Revolving Funds - Grant	66.458	242
Capitalization Grants for Drinking Water State Revolving Funds - Loan	66.468	281,837
Capitalization Grants for Drinking Water State Revolving Funds - Grant	66.468	<u>376,786</u>
Total Minnesota Public Facility Authority		1,547,326
Congressionally Mandated Projects	66.202	<u>444,495</u>
Total Environmental Protection Agency		1,991,821
U.S. Department of Transportation		
State of Minnesota Department of Transportation		
Airport Improvement Program	20.106	<u>374,073</u>
Total Federal Expenditures		<u><u>\$ 2,365,894</u></u>

City of Two Harbors
Notes to Schedule of Expenditures of Federal Awards

NOTE 1 - BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal Awards (the "Schedule") includes the federal award activity of the City under programs of the federal government for the year-ended December 31, 2025. The information in this Schedule is presented in accordance with the requirements of *Title 2 U.S. Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Because the Schedule presents only a selected portion of the operations of the City, it is not intended to and does not present the financial position, changes in net position, or cash flows of the City.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Expenditures reported on the Schedule are reported on the modified accrual basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

NOTE 3 - PASS-THROUGH GRANT NUMBERS

All pass-through entities listed above use the same Assistance Listing numbers as the federal grantors to identify these grants and have not assigned any additional identifying numbers.

NOTE 4 - INDIRECT COST RATE

The City did not elect to use the 10 percent de minimis indirect cost rate, as allowed under the Uniform Guidance.

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**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 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 (*Government Auditing Standards*), the financial statements of the governmental activities, the business-type activities, the discretely presented component unit, 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, 2025, and the related notes to financial statements, which collectively comprise the City's basic financial statements, and have issued our report thereon dated April 14, 2026.

Report on 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) as a basis for designing 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.

Our consideration of internal control was for the limited purpose described in the preceding paragraph 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. However, as described in the accompanying Schedule of Findings and Questioned Costs, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

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. We consider the deficiency described in the accompanying Schedule of Findings and Questioned Costs as Audit Finding 2025-001 to be a material weakness.

Internal Control over Financial Reporting (Continued)

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. We consider the deficiency described in the accompanying Schedule of Findings and Questioned Costs as Audit Finding 2025-002 to be a significant deficiency.

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 financial statements. 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 findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. 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 14, 2026



**Report on Compliance for each Major Federal Program
and Report on Internal Control over Compliance In Accordance
with the Uniform Guidance**

Independent Auditor's Report

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

Report on Compliance for Each Major Federal Program

Opinion on Each Major Federal Program

We have audited the City's compliance with the types of compliance requirements identified as subject to audit in the *U.S. Office of Management and Budget (OMB) Compliance Supplement* that could have a direct and material effect on the City's major federal programs for the year ended December 31, 2025. The City's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs.

In our opinion, the City complied in all material respects, with the compliance requirements referred to above that could have a direct and material effect on its major federal programs for the year ended December 31, 2025.

Basis for Opinion on Each Major Federal Program

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America (GAAS); the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States (*Government Auditing Standards*); and the audit requirements of *Title 2 U.S. Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Our responsibilities under those standards and the Uniform Guidance are further described in the Auditor's Responsibilities for the Audit of Compliance section of our report.

We are required to be independent of the City and to meet our other ethical responsibilities, in accordance with relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion on compliance for each major federal program. Our audit does not provide a legal determination of the City's compliance with the compliance requirements referred to above.

Responsibilities of Management for Compliance

Management is responsible for compliance with the requirements referred to above and for the design, implementation, and maintenance of effective internal control over compliance with the requirements of laws, statutes, regulations, rules and provisions of contracts or grant agreements applicable to the City's federal programs.

Auditor's Responsibilities for the Audit of Compliance

Our objectives are to obtain reasonable assurance about whether material noncompliance with the compliance requirements referred to above occurred, whether due to fraud or error, and express an opinion on the City's compliance based on our audit. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS, *Government Auditing Standards*, and the Uniform Guidance will always detect material noncompliance when it exists. The risk of not detecting material noncompliance resulting from fraud is higher than for that resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

Noncompliance with the compliance requirements referred to above is considered material, if there is a substantial likelihood that, individually or in the aggregate, it would influence the judgment made by a reasonable user of the report on compliance about the City's compliance with the requirements of each major federal program as a whole.

In performing an audit in accordance with GAAS, *Government Auditing Standards*, and the Uniform Guidance, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material noncompliance, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the City's compliance with the compliance requirements referred to above and performing such other procedures as we considered necessary in the circumstances.
- Obtain an understanding of the City's internal control over compliance relevant to the audit in order to design audit procedures that are appropriate in the circumstances and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of City's internal control over compliance. Accordingly, no such opinion is expressed.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and any significant deficiencies and material weaknesses in internal control over compliance that we identified during the audit.

Report on Internal Control over Compliance

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

Our consideration of internal control over compliance was for the limited purpose described in Auditor's Responsibilities for the Audit of Compliance section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies in internal control over compliance. Given these limitations, during our audit we did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, material weaknesses or significant deficiencies in internal control over compliance may exist that were not identified.

Report on Internal Control over Compliance (Continued)

Our audit was not designed for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, no such opinion is expressed.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

BerganKDV, Ltd.

Minneapolis, Minnesota
April 14, 2026

**City of Two Harbors
Schedule of Findings and Questioned Costs**

SECTION I - SUMMARY OF AUDITOR'S RESULTS

Financial Statements

Type of auditor's report issued: We issued an unmodified opinion on the fair presentation of the financial statements of the governmental activities, business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information in accordance with accounting principles generally accepted in the United States of America (GAAP).

Internal control over financial reporting:

- Material weakness(es) identified? Yes, Audit Finding 2025-001
- Significant deficiency(ies) identified? Yes, Audit Finding 2025-002

Noncompliance material to financial statements noted? No

Federal Awards

Type of auditor's report issued on compliance for major programs: Unmodified

Internal control over major programs:

- Material weakness(es) identified? No
- Significant deficiency(ies) identified? None reported

Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516 (a)? No

Identification of Major Programs

Assistance Listing No.: 66.458
Name of Federal Program or Cluster: Clean Water State Revolving Funds

Assistance Listing No.: 66.468
Name of Federal Program or Cluster: Drinking Water State Revolving Funds

Dollar threshold used to distinguish between type A and type B programs: \$1,000,000

Auditee qualified as low-risk auditee? No

City of Two Harbors
Schedule of Findings and Questioned Costs

SECTION II - FINANCIAL STATEMENT FINDINGS

Audit Finding 2025-001

Criteria:

Internal control that supports the City's ability to initiate record, process, and report financial data consistent with the assertions of management in the financial statements requires adequate segregation of accounting duties.

Condition:

During the year ended December 31, 2025, the City had a lack of segregation of accounting duties due to a limited number of office employees.

Management is aware of this condition and has taken certain steps to compensate for the lack of segregation. However, due to the small accounting staff needed to handle all of the accounting duties, the cost of obtaining desirable segregation of accounting duties can often exceed benefits which could be derived. Due to this reason, management has determined a complete segregation of accounting duties is impractical to correct. However, management, along with the City Council, must remain aware of this situation and should continually monitor the accounting system, including changes that occur.

Context:

This finding impacts the internal control for all significant accounting functions.

Cause:

There are a limited number of office employees.

Effect or Potential Effect:

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.

For the year ended December 31, 2025, an error correction was required to adjust beginning net position for the Gas Fund to reflect an overstatement of revenue in 2024. This adjustment affected beginning net position for the Gas Fund and business-type activities in the amount of \$88,000.

Recommendation:

Continue to review the accounting system, including changes that may occur. Implement segregation whenever practical.

Views of Responsible Officials:

Management of the City takes its responsibility for internal controls very seriously. The City has weighed the costs and benefits of an additional office employee to eliminate this risk and has determined the benefit does not exceed the cost.

The City's management team diligently follows the City's internal control policies to ensure the protection of public funds.

**City of Two Harbors
Schedule of Findings and Questioned Costs**

SECTION II - FINANCIAL STATEMENT FINDINGS (CONTINUED)

Audit Finding 2025-002

Criteria:

Internal control that supports the City's ability to initiate record, process, and report financial data consistent with the assertions of management in the financial statements requires adequate internal controls over significant revenue processes.

Condition:

During the year ended December 31, 2025, the City had a lack of internal controls over the utility billing process for water charges.

During our audit of water charges, we noted the ratio of gallons billed to gallons pumped was 52%. The American Waterworks Association has developed a benchmark of gallons billed to gallons pumped to equal at least 90%.

Context:

This finding impacts the internal control for utility billing.

Cause:

There are a limited number of office employees to investigate water loss.

Effect or Potential Effect:

The lack of internal control over water charges 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.

Recommendation:

Continue to review and investigate the ratio of gallons billed to gallons pumped ratio. We recommend the City increase their awareness of the disparity and strive to meet the benchmark of 90%.

Views of Responsible Officials:

Management of the City takes its responsibility for internal controls very seriously. The City will continue to investigate the ratio of gallons billed to gallons pumped to ensure the utility billing system is adequately capturing data and properly billing for water use.

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

None

SECTION IV - PRIOR YEAR FINDINGS AND QUESTIONED COSTS

None



Minnesota 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, the discretely presented component unit, 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, 2025, and the related notes to financial statements, which collectively comprise the City's basic financial statements, and have issued our report thereon dated April 14, 2026.

In connection with our audit, nothing came to our attention that caused us to believe that the City failed to comply with the provisions of the contracting - bid laws, depositories of public funds and public investments, conflicts of interest, public indebtedness, claims and disbursements, miscellaneous provisions, and tax increment financing sections of the *Minnesota Legal Compliance Audit Guide for Cities*, promulgated by the State Auditor pursuant to *Minnesota Statutes* § 6.65, insofar as they relate to accounting matters. 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, insofar as they relate to accounting matters.

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 14, 2026

FORM OF LEGAL OPINION

(See following pages)

FRYBERGER

— LAW FIRM —

June 25, 2026

City of Two Harbors
522 First Avenue
Two Harbors, MN 55616

[TBD]

**Re: *City of Two Harbors, Minnesota*
\$2,460,000 General Obligation Water and Sewer Revenue Bonds,
*Series 2026A***

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 444 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 8, 2026, 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

FRYBERGER, BUCHANAN, SMITH & FREDERICK, P.A

CLOQUET
813 Cloquet Ave.
Cloquet, MN 55720
p: (218) 879-6830

DULUTH
302 West Superior St.
Ste 700
Duluth, MN 55802
p: (218) 722-0861

SUPERIOR
1409 Hammond Ave., Suite 330
Superior, WI 54880
p: (715)392-7405

ST. PAUL
c/o 302 West Superior St.
Ste 700
Duluth, MN 55802
p: (651)221-1044

FRYBERGER LAW FIRM

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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 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 its date of issuance, bears interest which is (a) 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; (b) includable in taxable income of corporations and financial institutions for purposes of State franchise tax; and (c) 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; however, such interest on the Bonds may affect the federal alternative minimum tax imposed on certain corporations.

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.

FRYBERGER LAW FIRM

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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.

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.

FORM OF CONTINUING DISCLOSURE CERTIFICATE

(See following pages)

CONTINUING DISCLOSURE CERTIFICATE

This 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 \$2,460,000 General Obligation Water and Sewer Revenue Bonds, 2026A, dated June 25, 2026 (the “Obligations”). The Obligations are being issued pursuant to a Resolution of the Issuer dated June 8, 2026 (the “Resolution”). 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.

“Code” means the Internal Revenue Code of 1986, as amended.

“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.

“Financial Obligation” means, with respect to the Issuer a: (a) debt obligation; (b) derivative instrument entered into in connection with, or pledged as security or a source of payment for, an existing or planned debt obligation; or (c) guarantee of one of the foregoing. The term “Financial Obligation” shall not include municipal securities as to which a final official statement has been provided to the Municipal Securities Rulemaking Board consistent with this rule.

“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 _____, 2026, 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. Reference is also made to SEC Release No. 34-83885 (File No. S7-01-17) for additional information relating to the Issuer’s compliance with this Certificate.

“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, 2026, 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. In each case, the Annual Report may be submitted as a single document or as separate documents comprising a package, and may cross-reference other information as provided in Section 4 of this Disclosure Certificate; provided that the Audited Financial Statements of the Issuer may be submitted separately from the balance of the Annual Report and later than the date required above for the filing of the Annual Report if they are not available by that date; provided, however, unaudited financial information will be provided and the Audited Financial Statements will be submitted to the MSRB when and if available. The Issuer may provide the Annual Report by specific reference to documents previously provided to the MSRB or filed with the SEC; provided, however, that if the document so referenced is a final official statement within the meaning of the Rule, such final official statement must be available from the MSRB.

(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 Annual Report shall contain or incorporate by reference the Audited Financial Statements and updates of the following sections of the Official Statement to the extent such financial information and operating data are not included in the Audited Financial Statements:

- (a) Current Property Valuations
- (b) Direct Debt
- (c) Tax Levies & Collections
- (d) U.S. Census Data/Population Trend
- (e) Employment/Unemployment Data

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 10 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;
- (9) bankruptcy, insolvency, receivership or similar event of the Issuer;

or

(10) default, event of acceleration, termination event, modification of terms, or other similar events under the terms of a Financial Obligation, any of which reflect financial difficulties.

(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 10 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;

(7) appointment of a successor or additional trustee or the change of name of a trustee; or

(8) incurrence of a Financial Obligation or agreement to covenants, events of default, remedies, priority rights, or other similar terms of a Financial Obligation, any of which affect security holders.

(c) For 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 of 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 June 25, 2026.

CITY OF TWO HARBORS, MINNESOTA

By _____
Mayor

By _____
City Administrator

TERMS OF PROPOSAL

**\$2,460,000* GENERAL OBLIGATION WATER AND SEWER REVENUE BONDS, SERIES 2026A
CITY OF TWO HARBORS, MINNESOTA**

Proposals for the purchase of \$2,460,000* General Obligation Water and Sewer Revenue Bonds, Series 2026A (the "Bonds"), of the City of Two Harbors, Minnesota (the "City"), will be received at the offices of Ehlers and Associates, Inc. ("Ehlers"), 3001 Broadway Street, Suite 320, Minneapolis, Minnesota 55413, 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 8, 2026, 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 5:30 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.

AUTHORITY; PURPOSE; SECURITY

The Bonds are being issued pursuant to Minnesota Statutes, Chapters 444 and 475, as amended, by the City, for the purpose of financing the construction of various utility system improvements within the City. The Bonds will be general obligations of the City for which its full faith and credit and taxing powers are pledged.

DATES AND MATURITIES

The Bonds will be dated June 25, 2026, 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>
2028	\$130,000	2033	\$150,000	2038	\$180,000
2029	135,000	2034	155,000	2039	185,000
2030	135,000	2035	160,000	2040	195,000
2031	140,000	2036	165,000	2041	200,000
2032	145,000	2037	175,000	2042	210,000

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, 2027, 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 2028 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, Minneapolis, Minnesota ("BTSC"), to act as paying agent (the "Paying Agent"). BTSC 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, 2037, shall be subject to optional redemption prior to maturity on February 1, 2036, or any date thereafter, at a price of par plus accrued interest to the date of optional redemption.

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 June 25, 2026, 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 MATTERS

Legal matters incident to the issuance and sale of the Bonds and with regard to the tax-exempt status of interest on the Bonds under existing laws are subject to the approving legal opinion of Fryberger, Buchanan, Smith & Frederick, P.A., as Bond Counsel to the City. Bond Counsel has not examined nor attempted to examine or verify any of the financial or statistical statements or data contained in the Official Statement and will express no opinions with respect to such information. Additionally, except for statements on the cover page of the Official Statement and under the caption "TAX EXEMPTION" relating to Bond Counsel's opinion that the interest on the Bonds is not includable in gross income for federal income tax purposes, Bond Counsel has not independently verified any of the factual information contained in the Official Statement nor have they conducted an investigation of the affairs of the City for the purpose of passing upon the accuracy or completeness of the Official Statement. No person is entitled to rely upon their limited participation as an assumption of responsibility for, or an expression of opinion of any kind with regard to, the accuracy or completeness of any of the information contained in the Official Statement. See "FORM OF LEGAL OPINION" found in Appendix B.

SUBMISSION OF PROPOSALS

Proposals must not be for less than \$2,430,480 plus accrued interest on the principal sum of \$2,460,000 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) 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 IHS Markit (now part of S&P Global) at <https://ihsmarkit.com/products/municipal-issuance.html> or via telephone (844) 301-7334.

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 \$49,200 shall be made by the winning bidder by wire transfer of funds. Such Deposit shall be received by Ehlers no later than two hours after the proposal opening time. Wire transfer instructions will be provided to the winning bidder by Ehlers after the tabulation of proposals. 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 Deposit will be deducted from the purchase price at the closing for the Bonds.

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 Underwriter (Syndicate Manager) 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 winning bidder. 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 winning bidder on its proposal form to determine the issue price for the Bonds. On its proposal form, each bidder 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 winning bidder 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 will advise the City promptly after the close of the fifth (5th) business day after the sale whether it has 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.

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 requirements for establishing issue price of the Bonds, including, but not limited to, its agreement to comply with the hold-the-price rule, if applicable to the Bonds, 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 requirements for establishing issue price of the Bonds, including, but not limited to, its agreement to comply with the hold-the-offering-price rule, if applicable to the Bonds, as set forth in a selling group agreement and the related pricing wires, and

(iii) in the event that an underwriter or dealer who is a member of the selling group is a party to a third-party 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 requirements for establishing issue price of the Bonds, including, but not limited to, its agreement to comply with the hold-the-offering-price rule, if applicable to the Bonds, as set forth in the third-party 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 requirements for establishing issue price rule of the Bonds, including, but not limited to, its agreement to comply with the hold-the-offering-price rule, if applicable to the Bonds, 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 third-party distribution agreement to comply with its corresponding agreement to comply with the requirements for establishing issue price of the Bonds, including, but not limited to, its agreement to comply with 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 winning bidder selects the 10% test, the winning bidder 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 either (i) all Bonds of that maturity have been sold or (ii) the 10% test has been satisfied as to each maturity of the Bonds, provided that, the winning bidder's reporting obligation after the Closing Date may be at reasonable periodic intervals or otherwise upon request of the City or bond counsel.

(f) By submitting a proposal, each bidder confirms that:

(i) any agreement among underwriters, any selling group agreement and each third-party 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 third-party distribution agreement, as applicable, to:

(A) report the prices at which it sells to the public the unsold Bonds of each maturity allocated to it, whether or not the Closing Date has occurred until either all securities of that maturity allocated to it have been sold or it is notified by the winning bidder that either the 10% test has been satisfied as to the Bonds of that maturity, provided that, the reporting obligation after the Closing Date may be at reasonable periodic intervals or otherwise upon request of the City or bond counsel.

(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 or selling group agreement 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 a party to a third-party 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 third-party distribution agreement to:

(A) to promptly notify the winning bidder of any sales of Bonds that, to its knowledge, are made to a purchaser who is a related party to an underwriter participating in the initial sale of the Bonds to the public (each such term being used as defined below), and

(B) to acknowledge that, unless otherwise advised by the underwriter, dealer or broker-dealer, the winning bidder shall assume that each order submitted by the underwriter, dealer or broker-dealer is a sale to the public.

(g) Sales of any Bonds to any person that is a related party to an underwriter participating in the initial sale of the Bonds to the public (each term being used as defined below) 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 third-party 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 (A) more than 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), (B) 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 (C) 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 Underwriter (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 3001 Broadway Street, Suite 320, Minneapolis, Minnesota 55413, 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 (the "City")

June 8, 2026

RE: **\$2,460,000* General Obligation Water and Sewer Revenue Bonds, Series 2026A (the "Bonds")**
DATED: **June 25, 2026**

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 \$2,430,480) plus accrued interest to date of delivery for fully registered Bonds bearing interest rates and maturing in the stated years as follows:

_____ % due	2028	_____ % due	2033	_____ % due	2038
_____ % due	2029	_____ % due	2034	_____ % due	2039
_____ % due	2030	_____ % due	2035	_____ % due	2040
_____ % due	2031	_____ % due	2036	_____ % due	2041
_____ % due	2032	_____ % due	2037	_____ % due	2042

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 2028 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%.

A good faith deposit ("Deposit") in the amount of \$49,200 shall be made by the winning bidder by wire transfer of funds. Such Deposit shall be received by Ehlers no later than two hours after the proposal opening time. Wire transfer instructions will be provided to the winning bidder by Ehlers after the tabulation of proposals. 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. We agree to the conditions and duties of Ehlers and Associates, Inc., as escrow holder of the Deposit, pursuant to the Terms of Proposal. The Deposit will be deducted from the purchase price at the closing for the Bonds. 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 June 25, 2026.

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 the Bonds.

We have received and reviewed the Official Statement, and any addenda thereto, and have submitted our requests for additional information or corrections to the Final Official Statement. As Underwriter (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 either the: 10% test, or the 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 June 25, 2026 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 8, 2026.

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