

CITY MANAGER'S BUDGET MESSAGE

May 23, 2011

Mayor and City Council
City of Lexington

Dear Mayor Walser and City Council Members,

In accordance with North Carolina General Statutes, I hereby present you with the fiscal year 2011-12 proposed budget for the City of Lexington. The Census 2010 results, struggling local economy and lingering effects from the recent national recession has made this another challenging budget year and preparing a balanced budget has presented numerous difficulties. Not unlike many communities across the nation, Lexington has many needs but limited funding resources. Nonetheless, throughout the budget you will see strong support of the City Council's goals and guiding principles for governing.

In preparing the budget, personnel and operational reductions as well as a \$22,045 decrease in capital expenditures have been made to mitigate citizen and customer impacts. However, some rate and fee increases were necessary in order to maintain service levels. Of particular note, the proposed budget of \$95 million is down from the current year by a margin of \$839,924, which is generally due to the decreased wholesale cost of natural gas and a projected \$445,000 minimum reduction in State collected local revenues due to the Census 2010 population decline. The overall decrease in the proposed budget is brought about despite an increased wholesale cost of electricity and unfunded federal and state mandates placing upward pressure on the cost of service in the natural gas and water utilities. In addition, the budget includes \$500,000 for street resurfacing consistent with current year levels of funding in the General Fund, which is made possible by diverting \$319,000 savings from the completion of Phase 1 of the West Bypass Extension towards street resurfacing projects. There is no change in the property tax rate of \$.56 per \$100 of assessed valuation in the budget. The budget includes transfers made to the General Fund from the Electric and Natural Gas Funds. The proposed budget maintains existing City service levels.

Two key public service names are proposed to be changed in the budget. The former Sanitation department will be renamed Recycling and Waste Collection, in order to aid residents in better identifying the services provided by the department and to promote a 'green friendly' community. Secondly, the Water and Sewer Fund will be renamed Water and Wastewater Fund, in an effort to update the nomenclature to a commonly used utility reference in today's government arena.

Specific highlights of the proposed budget are discussed in detail on the following pages.

THE LOCAL ECONOMY AND BUDGET OUTLOOK

The proposed budget continues to be greatly impacted by local economic conditions. Over the past ten years, the City has suffered dramatic revenue loss from the closing of furniture and other manufacturing plants. These continuing impacts from industrial plant closings seem to reverberate throughout the City's budget long after the shut downs occur. Since 2001, a total of twelve industrial plants have closed and the City has lost in excess of \$9 million in annual revenues and over 3,000 jobs. If all of the \$9 million in lost City revenues had to be replaced by property taxes, that property tax rate

increase would be the equivalent of an additional 65 cents. The constant drain of lowered revenues and job losses is reflected in all utility funds, in the General Fund and is even felt at the golf course. Mergers and acquisitions, new technology, the foreign labor market and most recently the recession have been driving forces behind the local closings. Despite recent positive signals of recovery, equal economic replacement value remains in the distance for Lexington.

The national recession persists with a lingering effect on unemployment rates, consumer confidence and interest rates, which has an adverse effect on City revenue sources. Sales tax revenue is projected to fall below current year budget projections by \$65,000 and will experience a further decline of \$392,000 next year due to the Census 2010 figures, as discussed in further detail in the 'Other Major Impacts' section below. Interest rates are not expected to climb significantly in the next budget year; thus, interest income on City cash and investment balances in the proposed budget is projected to remain relatively stable with current year projections. To lessen the impact of dwindling revenue streams, the City took previous action to mitigate health insurance increases, which is reaping benefit in the proposed budget. By dramatically altering the health plan with reduced benefits effective May 1, 2009, City Council lessened the impact of future health insurance cost escalations. This change resulted in an 8% savings in the current year and an additional 10% savings or \$416,175 decrease in the proposed budget next year, while still providing adequate health insurance coverage to employees and retirees.

The City took a significant step to control its own economic future by purchasing the Lexington Furniture Industries Plant 1 (LFI Plant 1) property for \$1 million with payments paid out over previous budget years. Plant 1, which has been closed since 2003, contains 18 acres of land and over one million square feet of building space and is located adjacent to the heart of Uptown Lexington. The City faced real threats of declining appearance and tax base due to the expected acquisition of the property by absentee ownership if the City decided against the purchase. This acquisition has had an effect on the City's financial flexibility by reducing fund balance for a few years, which has since rebounded. The huge task of redevelopment of the property will continue to have financial impacts on City budgets. However, the infusion of \$89,167 of rental income from leased warehouse space to Lexington Home Brands is included in the proposed budget to offset the costs of redevelopment efforts of the property. The City has received environmental testing results demonstrating the vast majority of the property to be free of limitations on redevelopment. City Council also appointed a commission of capable citizens to focus on the redevelopment of the LFI Plant 1 property whose work is well underway.

OTHER MAJOR IMPACTS

Census 2010 population figures became available this spring, registering the City with an updated population of 18,931. The Census 2010 number is a 5% drop or 1,022 decrease in population from the last official census in 2000. However, the 18,931 population is a 2,489 or 12% decrease from the 2009 Certified Population figure that the State updates annually. The State Certified Population figure is an estimate the State prepares and uses for annual revenue distribution purposes. The City receives several State collected local revenues that are partially based on State per capita distribution models; those being the local option sales tax, beer and wine tax, and the Powell Bill gasoline tax which supports 32% of the City's street maintenance budget. Despite Lexington's recorded loss of population, various other local governments in Davidson County and the County itself experienced population growth with the Census 2010 figures, which may result in further detriment to Lexington's weighted share of the revenues. Thus, the proposed budget reflects a minimum loss of \$445,000 in sales tax, beer and wine tax and Powell Bill gasoline tax revenues to support government services funded in the General Fund.

In addition to the census impact and local economy remaining unpredictable, there are other factors that have posed a significant impact on the budget. Unfunded federal and state mandates in Street, Natural Gas, Electric and Water and Wastewater have affected the City budget collectively by \$655,000. Due to a federal mandate passed January 2008, the Street Department is required to upgrade signage with higher performing reflective materials standards. Due to a federal mandated Distribution Integrity Management Program in the natural gas industry, the City is also incurring costs for public awareness and a natural gas system routine inspection and pipe replacement program. Over the course of the next eight years, electric customers will be paying a surcharge for the State environmental provision that went into effect in 2008 which requires power companies to develop 10% renewable energy sources such as solar and wind in their portfolio. Finally, the State dictates certain water quality requirements that the City has to meet at the water plants and in setting aside a replacement funding source for the wastewater collection and water distribution system.

Continued reduced industrial consumptions in electric, natural gas, and water utilities are anticipated in the proposed budget year due to the plant closings and recession impacts. For example, industrial consumptions for City electric service have lowered by 84 million kWh or 75% since 2001. The North Carolina Municipal Power Agency No. 1 (NCMPA1) will implement a 5% wholesale electric rate increase in July 2011 that equates to approximately 6% purchased power cost increase to the City due to the industrial consumption losses and reduced wholesale power credits from NCMPA1. A projected \$6.00 per dekatherm price for natural gas is budgeted, which is significantly lower than the current year budgeted cost of gas of \$7.75 per dekatherm.

Weather has a profound impact on utilities' operating costs and revenues. Moderate winters, energy efficiency trends and drought conditions affect utility rates to customers, transfers from the utility funds to the General Fund and projecting revenues for the utility funds for budgeting purposes. Given typical weather, economic and energy efficiency trends, utility revenues in next year's budget have been predicated on lower consumptions. Mandates, industrial closings and weather trends prompted an independent rate study in water and wastewater in 2007-08. The results of that long range rate study recommended the last multi-year rate increase of 2.5% for water and 5% for wastewater in the proposed budget. Also having not been updated since 2008, the proposed budget will incorporate funding to undertake an independent natural gas rate study to equitably allocate costs across customer rate classes taking into account the losses of industrial base load, changes in available capacity and fixed costs, and unfunded mandates in the natural gas industry.

Twenty-three non-profit agencies requested funding for Grants to Agencies totaling \$395,250, which was reduced to \$302,250 in the proposed budget. City departments made over \$1 million in capital outlay requests; however, these requests were reduced to a total funding level of \$781,134. The General Fund subsidy of \$168,584 for the golf course covers precisely the annual debt service for the course renovations, which is consistent with the current year original budget. These factors, plus the strategy implemented to reduce spending levels to minimize the impact of local economic conditions and losses from State collected local revenues due to the Census 2010 population decline, account for the major differences between the current year budget and the proposed 2011-12 budget.

CITY ACCOMPLISHMENTS DESPITE THE RECESSION

Despite the recession that officially spanned December 2007 through June 2009 and the lingering impacts that continue still today, Lexington City government has been able to accomplish the following during this time:

- Maintained key service levels in public safety, recycling and waste collection, public utilities, streets, and recreation and parks
- Renovated Historic Southern Railway Freight Depot to house Farmers Market
- Attacked foreclosure problem by supporting establishment of Homeownership Center and successfully competed for and won \$2.1 million Neighborhood Stabilization Program grant
- Sought and won \$645,000 grant to build new Green Needles Park and expand Erlanger Park
- Received NC Rail Division support for restoration of passenger rail service to Lexington
- Sought and received \$700,000 federal grant to design multi-modal transportation station including passenger rail
- Completed modern Lexington Police Department Training Center paid entirely by confiscated illegal drug money, which is bringing other public safety units from across the State to Lexington to use the facility in exchange for free training for Lexington Police Department officers
- Completed new Natural Gas/Public Works Operations Center and new equipment sheds for the Street and Recycling and Waste Collection departments to replace outdated, inadequate facilities
- New, relocated Fire Station No. 2 to be complete this summer
- City Government has improved its credit rating to a AA-, received clean audit reports and the national Government Finance Officers' Association Certificate of Achievement for Excellence in Financial Reporting for 18 consecutive years
- Approved economic development grant incentives for United Furniture, Save-A-Lot distribution center, Vitacost, Sauers and Company Veneers, Diamondback Products, Johnson Concrete, Valendrawers, Piedmont Candy Company and Arneg resulting in the creation and/or retention of 1,100 jobs
- Out of 576 micropolitan areas in the United States, Lexington-Thomasville was the top ranked U.S. micropolitan area in both 2007 and 2010 for total corporate real estate expansion
- Continued support of Multicultural, July 4th and Barbeque festivals, Uptown Lexington events, Piedmont Triad Omnium bicycle race, and the April 2011 premiere of the BBQ Capital Cook-Off
- Expanded natural gas system to serve Southmont and Tyro communities
- Sought and awarded grant and installed new South State Street traffic signals
- Sought and awarded grant and installed Raleigh Road sidewalks
- Began commercial rollout recycling program
- Sought and awarded \$310,263 Energy Efficiency grants to install energy efficient improvements in city buildings
- City employees, City Council and retirees donated \$193,058 to United Way and the City was awarded 2011 Donna H. Black Award of Excellence
- Approved lease agreement for college wooden bat baseball team to play at Holt-Moffitt field
- Crime rate has dropped significantly
- Upgraded \$1.5 million of essential Fire Department equipment including aerial ladder and pumper trucks
- City Council and City Manager received Main Street Champions Award from NC Department of Commerce
- Electric Department received Reliable Public Power Award from American Public Power Association
- Approved extension of the City wastewater collection service to Central Davidson and Southmont areas, bringing to twelve the number of County schools that are now served and off failed septic tanks.

Via the aforementioned accomplishments and countless others, the Mayor and City Council have demonstrated leadership and vision in making investments in Lexington's new economy in the face of financial distress.

CITY MANAGER'S STRATEGY IN PREPARING THE PROPOSED BUDGET

In preparing the proposed budget, answers to the following questions helped to determine the general direction for the proposed budget:

- Can basic City services and partnerships for services be continued?
- With a persistent sluggish recovery from the recession, can the City avoid a property tax rate increase or employee layoffs or furloughs?
- What is the lingering impact of industrial plant closings, job losses and relentless unemployment on the City's budget?
- What effect will the aftermath of the housing market crisis and a persistent lack of consumer confidence have on the City's budget?
- What impact will unfunded federal and state mandates have on the City's budget?
- What can the City do to take advantage of technology and reengineer government operations to find efficiencies in order to combat revenue losses?

Answers to these questions, along with other guiding principles, provided the framework for setting budget priorities.

Specifically, some key goals during the budget development process were to exhaust every opportunity to maintain and attract new jobs and investment and continue investing in public infrastructure where financially feasible, while restructuring government in order to find efficiencies that limit budget and economic impacts on citizens and customers. In regards to the utilities, emphasis is placed on the need to operate each as a separate business with an ongoing goal to add customers to spread costs over a larger customer base, which will help alleviate the rate burden for all utility customers in the long run. Maintaining system reliability in the utility infrastructure continues to be of extreme importance to ensure service delivery in the years to come.

In addition, our staff continues to research investments in new technology to increase productivity, ensure and improve customer service response, and lower or stabilize operating costs. Some reduced level of investment is proposed to personnel pay and benefits in order to prevent significant job layoffs while maintaining service levels in a struggling economy. Continued support of partners and volunteers in cooperative efforts to maintain the quality of life for the citizens especially during these difficult economic times and to promote economic development were important objectives.

In order to cope with the industrial losses in revenues over the past few years, the City has limited the amount of funds spent on capital vehicles and equipment. In addition, personnel and operating spending have been severely restricted and strategic uses of fund balance have been used to balance the budget. The City has aggressively pursued and been successful in acquiring federal stimulus economic funding, federal and state grants, and drug forfeiture funds to help finance personnel, equipment and new initiatives; these efforts will definitely continue next year.

The proposed 2011-12 budget is balanced with \$700,000 in fund balance, an increase of \$50,000 from the current year. Fund balance, otherwise known as the City's General Fund savings account, was reduced by \$1.4 million over a three year timeframe but rebounded by \$318,000 in fiscal year 2009-10 and is estimated to increase by an additional \$200,000-300,000 in the current year. The projected increase to fund balance in the current year is due to restrained spending, lapsed salaries from unfilled positions and the ongoing suspension of the City's 401K contribution for employees. Fund balance can be strategically used during difficult economic times to minimize impacts to citizens but must be preserved to maintain the financial integrity of the City. It is also imperative that at a moment's notice,

the City is able to adapt to further economic deterioration or provide funding for unforeseen emergencies or opportunities like investing in infrastructure and incentives to bring about new jobs and investments for the community. Without these incentives and investments, the local economy may not recover. Fund balance provided the flexibility to take advantage of economic development opportunities such as the \$1 million purchase of the Lexington Furniture Industries Plant 1 property, a \$268,000 land acquisition to attract Arneg, a new manufacturer of refrigeration cabinets, and a \$68,300 land acquisition which resulted in United Furniture, a furniture manufacturer, locating in Lexington. Fund balance will also be relied upon to absorb any unexpected revenue shortfalls from further economic deterioration or unexpected withholdings in State collected local revenues that the City may face in the coming year, not unlike the State withholding two-thirds of the beer and wine tax last year.

As the City enters a new decade, important decisions affecting the City's future remain. With the manufacturing plant shutdowns, job losses and Census 2010 population decline, the City must retool itself and its image in order to compete in the global economy. A citizen led committee, coined as the Lexington Strategic Planning Committee, will convene in the coming year to better understand the needs of citizens and provide strategic guidance, planning and a vision for city government for the coming decade. Support of this strategic planning initiative, via the use of a facilitation consultant, is incorporated in the proposed 2011-12 budget.

Only by the willingness to understand citizen needs, bridge services to meet the needs of the community, and boldly step forward to pursue actions that can remake the image of this City to one of the 21st century can we hope to restore health and vigor to our local economy and quality of life.

BUDGET INITIATIVES AND SERVICE ENHANCEMENTS

Numerous short term and long term initiatives are funded in the 2011-12 budget. In order to reduce the cost of government and to be more effective in service delivery, the City is investing in new technology and implementing efficiency measures to reengineer government.

Although funding requirements have significantly reduced from the initial implementation stages in prior years, the proposed budget continues to support the effective utilization and enhancement of the computerized Geographic Information System (GIS) mapping project. GIS mapping is essential for timely and effective economic development recruitment, utilities planning and operations, land use planning, enhanced customer service and crime analysis just to name a few of the benefits the City, its citizens and customers can reap.

The City is in the process of implementing the automated meter reading (AMR) project. The AMR system will result in installing a device on approximately 35,000 utility meters which enables the meter readers to drive by and record readings from a vehicle based unit without having to exit the vehicle and physically read and enter the data from the meter in their current hand held units. Thus far, AMR has afforded a reduction in manpower of four full-time positions and associated operating and capital costs. Successful implementation of this project will continue to reduce the need for meter reader personnel in future years, as the utilities continue to expand the customer base and especially to more distant geographical areas. In fact, this budget recommends the deletion of one more meter reader position, an ultimate savings of \$28,000 annually. As such, the proposed budget begins the sixth year of an eight-year implementation plan to outfit electric, natural gas and water meters with AMR technology at a cost to the three utilities of \$467,750 in the proposed 2011-12 budget.

The public safety technology budget, leveraged by Controlled Substance drug forfeiture monies as opposed to citizen tax dollars, includes \$94,000 to acquire in-car printers and sustain wireless

technology support to equip all patrol and officer vehicles with laptops. The wireless networking of these laptops allows the officers to work efficiently in the field without having to return to the station. Also included is \$25,000 to seek a technological archiving solution, which will allow for easy search and retrieval of exponentially growing electronic data of police records.

Additional new technology funds include Supervisory Control and Data Acquisition (SCADA) system improvements for both the natural gas and water and wastewater utility services. The first, at a cost of \$50,000, continues second year funding of the phase-in of an efficiency improvement program to install remote radio frequency monitoring at approximately forty natural gas regulator stations and interruptible customers. This will allow phasing out of outdated modem and telemeter technology currently used for interruptible customers and free up manpower from physically monitoring regulator stations every week. Secondly, a second year allocation of \$33,000 is included at the wastewater treatment plant in order to electronically monitor and operate three lift stations for the wastewater collection system, allowing for the phasing out of the antiquated dial up system currently in place.

The proposed budget incorporates restructuring and consolidation of public utilities, public works, finance and information technologies, and fire and community development building safety inspection functions. Two vacant positions in the Fire Department will be reclassified to employ a full-time dedicated Fire Marshal and a Data Information Technician, which will aid in compliance with NC Office of State Fire Marshal mandated permits and inspections in the State Fire Code, as well as required documentation for Fire Department Insurance Services Office (ISO) ratings which are a key factor to hold down commercial insurance premiums for the community. Restructuring consolidations also result in the elimination of a utility director position. These efficiency measures combine to save \$56,494 in the coming year and an additional \$61,293 in salaries and benefits in future years, while still meeting key service delivery and public safety priorities.

Ultimately, investments in technological advancements and initiatives to seek efficiencies in the delivery of government services offer the best opportunities to create savings in City operations in the years to come.

INVESTING IN PARTNERS – GRANTS TO AGENCIES FUNDING

The City has a 20-plus year history of local support that initially began by assisting non-profit agencies with their power bills. For fiscal year 2011-12, the City received requests for grant funding from local non-profit agencies in the amount of \$395,250. The local job losses and economic conditions have impacted these agencies; and thus, are driving the increased funding requests. The current year level of funding to grant agencies is \$301,250, while the proposed budget recommends total Grants to Agencies funding of \$302,250, a less than 1% increase from current year funding.

These agencies touch many people and many aspects of citizens' lives such as: the arts; community appearance; youth, elderly, and family services; the homeless; terminal illness; chemical dependency; AIDS; the disabled; public safety; affordable housing; historic preservation; economic development; and medical care for citizens with low income. The City's financial support represents a partnership with each agency and the dollars leverage services unaffordable by the City alone. Indicated below is a percentage breakdown of the grants to agencies budget by broad areas served:

- 27% budgeted for economic development
- 25% budgeted for increasing homeownership
- 7% budgeted for neighborhoods, beautification and human relations

- 23% budgeted for the arts
- 18% budgeted for human services

For a listing of each agency and the corresponding individual grant amounts, please refer to page 40 of this document.

CAPITAL EQUIPMENT

Requests from City departments for capital purchases totaled over \$1 million. In order to balance the budget, substantial reductions were made to these requests. All City departments, with specific assistance offered by the Garage Department, continue to work together to extend the life of all vehicles and equipment and reduce the size of fleet to be maintained which has culminated in approximately \$750,000 in savings to date related to downsizing the large pooled equipment fleet such as backhoes and dump trucks. An additional 93 non-emergency vehicles will be pooled within the Garage Department in the proposed budget in an effort to reassign vehicles to maximize utilization, level budgeting dollars for replacements, and meet the goal of downsizing the City's fleet.

However, some equipment needs must be funded in order to sustain efficient and reliable City services. The proposed 2011-12 budget includes \$781,134 for capital equipment. The major items include \$83,000 to sustain a disaster recovery and storage backup system for the City's exponentially growing data network, \$217,553 for potential vehicle replacements once all vehicles are reassigned for maximum utilization in the departments, as well as nine patrol vehicles and various police technological upgrades and crime detection initiatives paid for out of Controlled Substance funds totaling \$308,202. Details regarding capital equipment along with corresponding amounts for each department can be found located within this document behind the tabs for the various funds.

CAPITAL CONSTRUCTION PROJECTS

A \$4.2 million Build America Bond installment financing was issued April 15, 2010 to fund the relocation of Fire Station No. 2 for \$1.55 million, the replacement of dilapidated sheds for the large equipment of the Street and Recycling/Waste Collection departments in the amount of \$350,000, and the first phase of expansion of the utilities operations center for \$2.3 million. The replacement sheds and the first phase of the expanded utilities center are complete. The Utilities Operations Center has consolidated the Natural Gas and Public Works division of the Water and Wastewater utility operations. Having expanded the natural gas system out into various areas of Davidson County with added customer base and line maintenance, Natural Gas personnel had outgrown their current facility; and the Public Works division was operating out of an inadequate 1946 structure that was in need of expensive repairs. Consolidating the two utilities is resulting in efficiencies gained by the utilities sharing office space and equipment. Construction is well underway for the Fire Station No. 2 facility with an estimated completion date of August 2011; and the debt service appropriations for each of these projects, net of the 35% economic stimulus credit from the federal government, is included in the proposed budget: \$169,186 in the General Fund, \$151,377 in the Natural Gas Fund and \$53,428 in the Water and Wastewater Fund. Due to the timing of expired and refinanced debt payments, lowered operating budgets and the strategic use of natural gas rate stabilization resources available, none of these capital projects result in higher property tax or utility rates for citizens or customers next year.

A key electric system reliability improvement is funded in the proposed budget. A 44KV electric loop feed will be constructed from Hickory Street substation to the Cotton Grove substation in the estimated amount of \$550,000, which will result in a second feed of power to minimize future outage conditions for manufacturing and all other customers on this key service line. This project will be funded from a strategic withdrawal from electric capital reserve funds, which prevents any further

detrimental impact to the rate increase proposed for electric customers. Having not been formally evaluated and updated since 1994, the proposed budget also includes \$85,000 to hire an engineering consultant to review the electric distribution system and identify future capital improvement needs.

ORGANIZATIONAL CHANGES AND EMPLOYEE BENEFITS

The proposed budget does not include funding for the City's "pay for performance" employee merit plan, which was reduced in the current year from the traditional 0-5% to 0-2% due to the economic climate. By not funding the employee merit plan in the proposed budget, the result is a savings of \$220,508. The City's pay plan consultant recommended a 2% cost of living adjustment to keep pace with the market at a cost of \$309,625; but no funding is included for this market salary adjustment either. The City will also implement an efficiency maneuver to transition to biweekly payroll in the coming year, versus employees being paid weekly presently. These recommended measures help to mitigate the declining revenues from Census 2010 and post-recession status of the local economy.

The cost of employee longevity pay remains funded at \$313,203. Longevity pay is a percentage of gross salary that is paid to eligible tenured employees in December. The percentage ranges from 0-2.5% based on years of service. Employees become eligible for longevity after completing three years of continuous service with the City. To help counterbalance rising health insurance costs, a significant reduction to the level of health insurance benefits for employees and retirees was implemented effective May 1, 2009; the City is now reaping the positive financial impact of this action, resulting in a 10% cost savings in the 2011-12 proposed budget of \$416,175.

Funds dedicated to a 401K City contribution of 2% for all employees, with the exception of sworn police officers, was suspended beginning July 1, 2009 and will continue in the coming budget year resulting in a \$234,595 savings next year. North Carolina General Statutes require the City contribute 5% for sworn police officers; thus, that funding will continue in the coming year. As a tool to be used to retain a professional workforce amidst salary freezes and benefit reductions, the budget does include an appropriation of \$100,000 reserved for the City Manager to implement a productivity and efficiency rewards program for employees.

Effective July 1, 2011, the Local Government Employees Retirement System Board of Trustees is increasing the base employer contribution from 6.45% of payroll to 6.97% for general City employees and from 6.41% to 7.04% of payroll for law enforcement employees, consequentially an \$86,499 increase in personnel benefit budgets next year. The State notified local governments last year this was necessary due to the significant market losses suffered in 2008. Prior to the first of these increases beginning July 1, 2010 in the current budget, the employer's contribution rate had not increased in over 20 years. Future budget year increases are expected based on the recommendations from the Future of Retirement Study Commission, consisting of appointees by the State Treasurer to make recommendations about the future of the state and local government retirement systems.

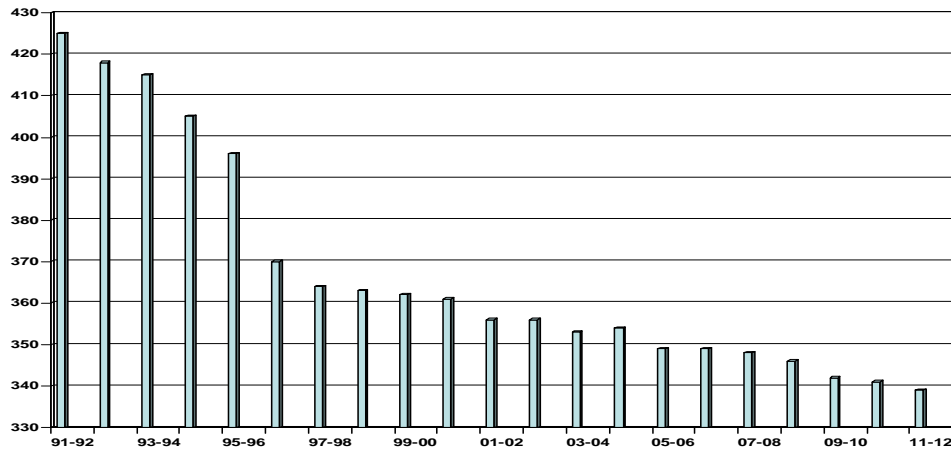
The proposed budget incorporates restructuring and consolidation of public utilities, public works, finance and information technologies, and fire and community development building safety inspection functions. As part of the restructuring efficiencies, the proposed budget contains the reclassification of two full-time positions for an annual savings of \$13,864. Two vacant positions in the Fire Department will be reclassified to employ a full-time dedicated Fire Marshal and a Data Information Technician for the Fire Department. The Fire Marshal will aid in compliance with NC Office of State Fire Marshal mandated permits and inspections in the State Fire Code; additionally, this new position will be physically located in the Community Development office in order to improve customer service and expedite building construction plan review and inspections. The Data Information Technician will

assist with the required documentation for Fire Department ISO ratings, which are a key factor in holding down commercial insurance premiums for the community.

The proposed budget also includes the reduction of two full-time positions for a savings of \$42,630 in the proposed budget; and fully realized annual savings of \$131,972 in the following year 2012-13, due to severance pay obligations and the timing of one position being eliminated in the spring of 2012 after the AMR meter change-outs are completed for next year. Restructuring consolidations allow for the elimination of a utility director in the Electric Department and the success of the AMR project implementation allow for reducing one meter reader position in the Meter Reading Department.

The effect of total full-time positions will be reduced from 341 to 339. The reduction of two full-time positions, combined with the annual savings of \$13,864 from two personnel reclassifications in the Fire Department, result in a total budget decrease of \$56,494 next year. As depicted by the graph below, the City will have eliminated 86 full-time positions, an annual rate of reduction of virtually five positions a year over the 20 year period. These reductions have been achieved by a combination of automation, new technology, outsourcing, restructuring and the effective use of part-time employees and interns. For a detailed position count by fund and department, please refer to pages 9-10 of this document.

Full-Time Positions



TRANSFERS BETWEEN CITY FUNDS

The Electric Fund and the Natural Gas Fund transfer monies to the General Fund each year, which helps balance the General Fund budget. These transfers serve as dividends to municipalities that own and operate utilities locally. The transfer in the current year for the Electric Fund is \$1.35 million, while the transfer for the Natural Gas Fund currently stands at \$801,429. The Electric Fund transfer remains budgeted for 2011-12 at \$1.35 million; while the Natural Gas Fund transfer is budgeted at \$832,602, a \$31,173 increase. The expansion of the natural gas system allows for the increased transfer. The budgeted transfer amounts for fiscal year 2011-12 are within the State of North Carolina’s established guidelines, which govern the recommended dividend amounts transferred from utility funds to the General Fund.

The General Fund transfers monies to the Golf Fund if needed to balance the Golf Fund budget. The proposed budget does include a subsidy transfer of \$168,584, which precisely covers the debt payment on the golf course renovation loan from 2003. This debt will be paid off in 2018.

CONTINGENCY

The 2011-12 proposed budget contains two contingency appropriations which are \$150,000 in the Water and Wastewater Fund and \$40,000 in the Golf Fund; both of which are designed to hedge against further unforeseeable revenue deterioration or build working capital reserves. In addition, the total appropriation of \$100,000 reserved for the City Manager to implement a productivity and efficiency rewards program for employees can be found split 50/50 between the General Administration contingency line-item of the General Fund and the Utility Administration contingency line-item of the Utility Administration Fund.

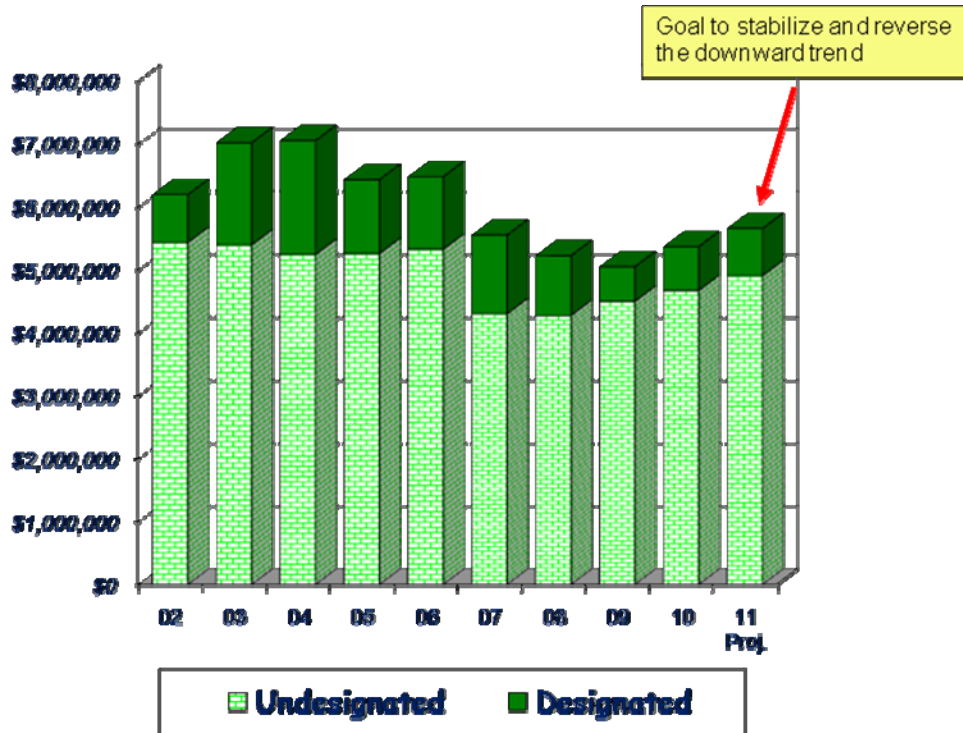
In the General Fund, the City will rely on a strong fund balance to cover any unexpected events or emergencies. The following table estimates available fund balance in the General Fund for next fiscal year.

FUND BALANCE PROJECTION

Unreserved Fund Balance 6/30/10 (31% of FY 09-10 expenditures)	\$5,361,106
Projected Expenditures FY 10-11 (less administrative charges)	(19,532,110)
Projected Revenues FY 10-11 (less administrative charges)	19,822,549
Projected Available Fund Balance 6/30/11	\$5,651,545
Projected Fund Balance Available for Appropriation for FY 11-12	\$5,651,545
Divided by General Fund Budget for FY 11-12 (less administrative charges)	\$18,516,641
City of Lexington Fund Balance Percentage Projection	30.5%
Projected Fund Balance Available for Appropriation for FY 11-12	\$5,651,545
Less Recommended Appropriation for FY 11-12	(700,000)
Remaining Fund Balance Available for Appropriation	\$4,951,545

The City Council has consistently listed “maintain the City’s financial strength” as one of its top goals. It is important to remember that the City significantly reduced fund balance by \$1.4 million cumulatively over a three year timeframe in acquiring the Lexington Furniture Industries Plant 1 property, land acquisition related to the incentive to attract Arneg to the City and in order to absorb the recessionary impacts affecting revenue losses and increased health insurance costs. However, it began to rebound with an increase of over \$318,000 as of June 30, 2010 and is expected to increase by an additional \$200,000-300,000 in the current year due to restrained spending, savings from lapsed salaries from unfilled positions and the ongoing suspension of the City’s 401K contribution for employees. The following chart demonstrates the City’s strong commitment to healthy and consistent levels of General Fund reserves over ten years and the rationale for recommending strategic reliance on fund balance in the coming budget year.

HISTORY OF GENERAL FUND BALANCE



MISCELLANEOUS FEE CHANGES

The City practices controlling costs by assigning appropriate fees for services to citizens and customers using those services, as opposed to general citizen or customer based funding through taxes or utility rates. City staff has evaluated current fee structures and is proposing new fees to comply with the NC Office of State Fire Marshal mandated fire permits and inspections, as well as changes to the following fees for the 2011-12 budget:

- Fire Re-inspection and Fire Lane Violations fee increases
- New Fire Life Safety Violation fee
- New Fire Prevention Operational and Construction Permit fees
- Community Development Overgrown Lot/Junk and Debris Administration fee increase
- Community Development Commercial Certificate of Occupancy fee increases
- Community Development Commercial Plan Review fee increases and restructuring
- Recycling and Waste Collection Special Pickup/Disposal fee increase
- New Electric Visit Charge fee for non-system related outages

Please refer to page 156 (and the corresponding attachments) of this document for specific fee structures that will change and the corresponding amounts.

UTILITY RATE CHANGES

Key factors affecting the decisions to recommend changes to utility rates as well as a brief synopsis of the rate changes are outlined below. However, please refer to page 156 (and the corresponding attachments) of this document for specific proposed rate structures.

Electric Rates:

Since July 1, 2001, City electric industrial customer consumption due to plant closings has dropped by 75%. Despite the City's intense efforts to trim \$1.4 million or 30% of operations and maintenance cost reductions from the budget over the last ten years, the City has received a \$7.4 million or 23% increase in wholesale power costs from the North Carolina Municipal Power Agency No. 1 during that same time period. The Power Agency is passing on a 5% wholesale power cost increase to the City effective July 1, 2011; however, this increase equates to approximately 6% or \$2.3 million annual cost increase for the City due to industrial load loss and reduced wholesale power credits from NCMPA1. Proposed rate changes were prepared by ElectriCities' rate analysts and reflect only the wholesale power increase; while the City reengineered electric operations for savings of \$504,000 and strategically used \$500,000 of the two year option for the surplus energy credits to absorb the loss of revenues from plant closings and reduced electric load, which prevented a higher rate increase to customers. Electric customers can expect to see an average electric rate increase of 5% beginning July 1, 2011. For a typical residential customer who uses 1,000 kWh's per month, this results in a monthly average of \$5.99 more on their utility bill. However, this may not be the exact percentage or dollar change a customer will see on a bill because the change in a customer's bill varies depending on consumption levels at various intervals of the year and the uniqueness of that particular account.

Over the course of the next few years culminating in 2015, electric customers will be paying an increasing surcharge known as Renewable Energy Portfolio Standards (REPS) for the State environmental provision that went into effect in 2008 which requires power companies to develop 10% renewable energy sources such as solar and wind in their portfolio. The State mandated monthly surcharge that will be assessed to each electric customer beginning July 1, 2011 is as follows: residential \$.42, commercial \$2.21, and industrial \$21.42.

Water and Wastewater Rates:

Not unlike the Electric Fund, the City's Water and Wastewater Fund revenues have suffered dramatic reductions in industrial consumptions due to the closing of manufacturing plants. This consumption loss is compounded by drought conditions which have resulted in a persistent mindset of voluntary conservation measures by the customer base. Consumption estimates next year are based on relatively flat consumption levels in each class of customer (i.e. residential, commercial, and industrial). Utility Advisors' Network, Inc. conducted an independent rate analysis for the City in 2008 due to the consumption losses and ever increasing mandates and funding required to maintain reliability of the water and wastewater treatment plant operations. Taking into account the consultant's multi-year rate adjustment recommendation and to maintain cash reserves for future mandates, a 2.5% water and a 5% wastewater rate increase is proposed to be effective July 1, 2011 for the 2011-12 budget. For a residential water and wastewater customer who uses 7 CCFs or approximately 5,200 gallons per month, the rate adjustment beginning in July 2011 will increase a bill by \$2.14 per month.

Natural Gas Rates:

Two components make up the rate charged to natural gas customers: (1) base rate and (2) commodity cost of gas. The base rate pays for general operating costs associated with providing natural gas service, excluding the commodity cost of natural gas. Despite traditional warmer winter weather and energy efficiency trends as well as plant closings reducing consumption levels, no base rate increase is proposed for 2011-12 achievable due to the reengineering efforts by the Natural Gas department and \$483,000 of annual debt payments expiring July 2011. A projected \$6.00 per dekatherm price for the commodity cost of natural gas is budgeted, lower than the \$7.75 budgeted average cost of natural gas in the current year. Natural gas consumption estimates are based on lower expected consumptions; which

are offset somewhat by expansion efforts resulting in the anticipated addition of 364 residential equivalents from customer base growth in the expansion areas.

RATE AND FEE IMPACTS ON RESIDENTS

The property tax rate will remain static in the proposed budget at \$.56 per \$100 assessed valuation, resulting in no additional impact on residents. However, the proposed utility rate increases will impact most City residents.

For a residential water and wastewater customer who uses 7 CCFs or 5,200 gallons, the monthly bill will increase by \$2.14 beginning with July 1, 2011 consumption; resulting in a total increase to residential customers of \$25.68 over the course of next budget year.

The proposed July 1, 2011 average 5% electric rate increase will affect electric utility customers depending on their consumption levels of electricity and the uniqueness of each customer account. For a typical residential customer who averages 1,000 kWh’s per month, the bill will increase an average of \$5.99 per month or \$71.88 per year. In addition as discussed earlier in the Electric Rates section, a residential customer will pay a REPS surcharge of \$.42 each month beginning July 2011.

However based on the past two winters being the coldest in decades, a restoration of trending warmer winter weather patterns and an anticipated stabilized lower cost of natural gas could mitigate some of these increases next year for customers. A utility customer that has all four services of water, wastewater, electric and natural gas could see the collective annual total of their bill be relatively stable in the coming year as compared to this year. In other words if winter heating consumption levels reduced for a customer with all utilities, the decrease in the consumptions from electric and natural gas by the customer could help to mitigate the increases in water and wastewater and electric services over the course of the coming year.

BUDGET COMPARISON

In summary, a comparison of the proposed fiscal year 2011-12 budget versus the current fiscal year 2010-11 budget is outlined in the table below.

**CITY OF LEXINGTON
BUDGET SUMMARY AND COMPARISON**

Fund	10-11 Budget	11-12 Budget
General Fund	\$20,906,860	\$20,490,088
Controlled Substance	1,009,966	1,131,690
Special Tax District	197,526	85,310
Electric Fund	46,580,966	49,721,111
Water & Wastewater Fund	8,080,441	8,626,213
Natural Gas Fund	18,246,189	14,121,304
Golf Fund	911,402	917,710
Total City Budget	\$95,933,350	\$95,093,426

To reiterate the chief differences, leading to the \$839,924 decrease from the \$95.9 million current budget to the \$95 million proposed budget, are generally due to the decreased wholesale cost of natural gas and a projected \$445,000 minimum reduction in State collected local revenues due to the Census 2010 population decline. The overall decrease in the proposed budget is brought about despite an increased wholesale cost of electricity and unfunded federal and state mandates placing upward pressure on the cost of service in the natural gas and water utilities. In addition, the budget includes \$500,000 for street resurfacing consistent with current year levels of funding, which is made possible by diverting \$319,000 savings from the completion of Phase 1 of the West Bypass Extension towards street resurfacing projects.

SUMMARY AND CONCLUSION

The City budget is the ultimate partnership between City Council, staff, citizens, customers and partners in the Lexington community. In the face of tough economic times, the proposed budget reflects a balanced approach of limiting impacts to its citizens and customers while providing funding for economic development and quality of life initiatives. The budgeted funding will help weather the storm of our local economy while simultaneously maintaining and protecting important infrastructure; and the investments in new technology and restructuring will improve City government efficiency and effectiveness.

In conclusion, City Council's general approach to governing remains highlighted in the budget for fiscal year 2011-12; those directives being: to expand citizen involvement, employ professional staff, pursue partnerships, proactively plan, make strategic investments, maintain financial integrity, and take calculated risks.

The City Budget is City Council's Number One Policy Statement

- Economic development initiatives are pursued
- Service levels are set
- Partnerships are nourished
- New technology is acquired
- Community's security is enhanced through public safety
- Service efficiencies are sought
- Public schools are supported
- Supports City employees in delivering efficient and effective services
- Public infrastructure is built and maintained
- Recreation for citizens is provided
- Public health is guarded by recycling and waste collection and water resources
- Reliability of utility services is funded
- Key City services necessary to support local economy are maintained
- City financial integrity is maintained to meet service and debt obligations
- Customer service is enhanced
- Affordable housing is supported
- Improved quality of life is sought for all citizens

The City's Annual Budget is the ultimate partnership between City Council, City staff, citizens, customers and partners. The budget is hereby formally presented to City Council at the May 23, 2011 City Council meeting and City Council is requested to set a public hearing date for June 13, 2011 at 7:00 pm in City Hall. After holding the public hearing and if there are no other changes, I recommend the fiscal year 2011-2012 City Budget for adoption by City Council.

Respectfully submitted,

A handwritten signature in blue ink that reads "John L. Gray". The signature is written in a cursive style with a large initial "J" and a long, sweeping underline.

John L. Gray
City Manager

FACTS AND INFORMATION ABOUT THE CITY OF LEXINGTON, NORTH CAROLINA

History

The City of Lexington, North Carolina, was settled in the industrial region of North Carolina known as the "Piedmont Triad Area" in 1775. Lexington was incorporated in 1828 by the North Carolina General Assembly and became the county seat of Davidson County in 1847. Lexington has a long heritage in furniture making and "Lexington Style" barbecue.

Location

With a land area of 18 square miles, Lexington is centrally located in the heart of the Piedmont Triad Area; situated no more than 30 minutes from the cities of Winston-Salem, Greensboro, and High Point as well as the Piedmont Triad International Airport. Lexington is approximately 60 miles from Charlotte and approximately 90 miles from Research Triangle Park near Raleigh.

Geography and Climate

Lexington is just a few hours from the beautiful beaches of both North and South Carolina and less than 2 hours from a relaxing scenic mountain ride along the Blue Ridge Parkway. Closer to home, the Yadkin River borders Davidson County to the west with High Rock Lake serving as one of the primary reservoirs and one of the area's best recreational facilities. With January's average high temperature of 50 degrees, even the coldest month provides ample opportunity to get out and discover Lexington.

Population and Demographic Statistics

The Census 2010 population results record Lexington's population at 18,931. This revised population figure is a 1,022 or 5% decrease from the Census 2000 results and a 2,489 or 12% decrease from the State's 2009 Certified Population estimate. The population distribution is 52% female and 48% male, with 24.6% of the population under age 18 and 15.4% of the population over age 65. The median age in the City of Lexington is 38.8 while the median age in the U.S. is 36.9. The population distribution by race is as follows: African American – 30%, Asian – 2%, White – 58%, Hispanic – 10%.

The average household income is \$29,943. The March 2011 unemployment rate for Davidson County was 10.9%, compared to the State of North Carolina rate of 9.7% and the Winston-Salem metropolitan area rate of 9.4%.

Government

The City has a Council-Manager form of government and is governed by an eight-member City Council consisting of two members elected at large and six elected by ward. The Council operates under the guidance of a popularly elected Mayor. Council members are elected on a nonpartisan basis for staggered four-year terms; and the Mayor is elected on a nonpartisan basis for a two-year term. The Mayor may vote only in case of a tie among members of the City Council. The City Council is responsible for establishing policy, passing ordinances, adopting the budget, appointing committees and hiring the City's chief administrative officer, the City Manager, and the City's legal counsel. The City Manager is responsible for carrying out the policies and ordinances of the governing board, for overseeing the day-to-day operations of the City, and for the appointment of the Department Heads who direct City staff to deliver the services and to meet the goals of the organization. The City provides a full range of services including police and fire protection, recycling and waste collection services, the construction and maintenance of streets and infrastructure,

recreational activities including a municipally owned golf course, cemetery services, and utility services.

Utilities

The City of Lexington has been providing reliable utility services since 1904 and currently owns and operates four utility services: a water treatment and distribution system, a wastewater treatment and collection system, an electric distribution system, and a natural gas distribution system. These enterprise funds serve portions of Davidson County in addition to servicing citizens within the City corporate limits.

Transportation

Interstate and Business 85 pass directly through Lexington along with US 52, US 64, US 29/70, and NC 8. Other NC highways serving the Lexington area include Highways 47, 49, 109, and 150. The proximity to I-85 and US 52 places the City an hour or less from major population centers such as Charlotte, High Point, Greensboro, and Winston-Salem; and the City is just over an hour from the Research Triangle Park. For rail, freight carriers such as Winston-Salem Southbound and Norfolk Southern serve the area; and passenger access via Amtrak is only 15 minutes away in Salisbury or High Point. The City is working with the Rail Division of the NC Department of Transportation to secure a passenger rail stop in Lexington.

For air travel, the Davidson County Airport is located just 3 miles southwest of Lexington and can accommodate executive travel needs. A full taxiway to a 5000' x 100' runway paves the way for an airport that continues to expand. For commercial flight options, Lexington is approximately an hour or less from Charlotte-Douglas International and Piedmont Triad International in Greensboro, and just over an hour from the Raleigh-Durham International airport.

Public Safety

The Lexington Police Department maintains order and offers public safety services within its respective jurisdiction. The Police Department strives to be a very progressive law enforcement agency by continued training in fields such as fingerprints, firearms, investigative techniques, crime prevention, patrol procedures and community-oriented policing.

The Lexington Fire Department provides fire and life safety protection to the community twenty-four hours a day operating 3 fire stations throughout the City. The department has evolved the traditional mission of fire suppression to include: rescue services, hazardous material abatement and medical response. Additionally, the department provides decentralized, comprehensive education and fire code compliance programs. The Fire Department has an Insurance Services Organization (ISO) class 3 rating.

Education

The Lexington City Schools system is an independent administrative school district comprised of six schools serving grades K through 12. Private schools are also available within the City limits. For higher education, Lexington hosts Davidson County Community College, which offers over 50 instructional programs to help prepare students for enhanced employment. In addition, located within approximately 90 miles from Lexington are over two dozen colleges and universities including well-renowned higher education institutions such as University of North Carolina at Chapel Hill, NC State University, Wake Forest University, Duke University, High Point University, and University of North Carolina at Charlotte.

Culture and Recreation

The North Carolina Legislature has designated Lexington as "The Hickory Smoked Barbecue Capital of North Carolina." Each year in late October, over 100,000 visitors experience Lexington first hand during the annual Barbecue Festival. The Barbecue Festival is held in Uptown Lexington on an eight-block stretch of Main Street. Over four hundred exhibitors sell everything from handmade crafts to homemade fudge. Five stages of entertainment showcase local and national artists. The festival is designed for people of all ages to enjoy and includes a special section of rides and games for children known as Piglet Land. Barbecue is served out of three main tents, two at the town square and another at the north end of the festival near Piglet Land. To expand the barbecue tourism attraction Lexington has to offer, a Barbeque Cook-Off made its debut in April 2011. Sanctioned by the Kansas City Barbeque Society, the event brought competitive chefs and judges from across the United States to Uptown Lexington. This event is poised to become Lexington's spring compliment to the annual Barbecue Festival that celebrated their 27th anniversary this past year.

Internationally known artist Bob Timberlake, a Lexington native and resident, has a beautifully constructed gallery and welcome center just off Interstate 85 within the City limits. The gallery displays works of art as well as furniture and unique home décor items available for retail purchase. The gallery offers open houses throughout the year at which patrons can meet Bob Timberlake and have him personally sign their Timberlake collectables.

The excitement of NASCAR Sprint Cup racing can be found at the nearby Richard Childress Racing (RCR) Museum in Welcome, North Carolina. A patron can view many of RCR's greatest racecars along with famous machines from Indy car and the National Hot Rod Association. Richard Childress's personal collection of hot rods can also be spotted along with many trophies, awards, and unique memorabilia.

Richard Childress has anchored the west gateway entrance to the City with a 65-acre vineyard complex at the intersection of US Highways 64 and 52. This location also serves as the gateway to the Yadkin Valley, the only federally designated grape growing region in the State of NC. Childress Vineyards is a 35,000 square foot winery inspired by the Italian Renaissance architecture of rural Tuscany and produces approximately 40,000 cases of 9 varieties of premium European wines. The winery includes a banquet hall that can accommodate 500, a bistro, as well as a wine tasting room and gift shop. The winery includes another 15 acres comprised of a hotel and retail shop space known as Vineyards Crossing.

Several natural attractions complement the Lexington area. Bordering the western part of Davidson County, the Yadkin River offers a place for many to fish and boat. The river fills High Rock Lake in the southern portion of the county, where skiing and sailing are popular alternatives. High Rock Lake has hosted The BASS Masters Classic fishing tournament. In the southern most part of Davidson County, Uwharrie National Forest can be found for the hiking and mountain biking enthusiasts. Finally, Boone's Cave Park in western Davidson County is the area believed to have been one of Daniel Boone's homes during his adventurous life.

The City of Lexington provides an extensive list of recreational alternatives. City facilities include 16 parks, 2.75 miles of walking trails, 2 pools, 15 tennis courts, 9 athletic fields, and 12 basketball courts, conveniently located on 334 acres around the City. Completely renovated in 2004, the City's municipally owned 18-hole championship golf course rounds out the list of recreational activities.

Lexington Golf Club was voted "Top 5 Public Renovations of the Year for 2004" by Golf Inc. Magazine, a highly regarded trade journal in the golf industry.

Recreation in the area is further enhanced by the City's proximity to exciting professional and collegiate sporting events ranging from Carolina Panthers and Bobcats professional football and basketball to Atlantic Coast Conference basketball at top notch programs such as the University of North Carolina at Chapel Hill, Duke University, NC State University and Wake Forest University.

Healthcare

Medical services are readily available in the City of Lexington. Within Davidson County, there are more than 150 doctors in specialties ranging from internal medicine to neurology. Lexington Memorial Hospital recently merged with Wake Forest University Baptist Medical Center to provide a full complement of modern health care services. Other nearby medical facilities include Thomasville Medical Center, Veterans Administration Medical Center in Salisbury, High Point Regional, and Wake Forest University Baptist Medical Center in Winston-Salem, a world-renowned teaching and research hospital offering general care as well as specialized treatment.

Schedule of Top Ten Taxpayers for Fiscal Year Ended June 30, 2010

Taxpayer	Type of Business	Assessed Valuation	Tax Levy	% of Assessed Valuation
Kimberly Clark Corp.	Tissue Products	\$ 86,379,555	\$ 483,726	5.79%
Jeld-Wen Inc.	Windows and Doors	22,364,811	125,243	1.50%
Wal-Mart	Retail	16,241,889	90,954	1.09%
NewBridge Bank	Banking	15,441,971	86,475	1.03%
Stanley Furniture Co. Inc.	Furniture	12,797,719	71,667	0.86%
Diebold Southeast Mfg. Inc.	Security Delivery Systems	12,389,448	69,380	0.83%
Chesapeake Printing & Packaging Co.	Printing	11,724,262	65,656	0.79%
Childress Winery & Vineyards	Viniculture	9,791,333	54,832	0.66%
Parkdale Mills Inc.	Textiles	7,921,911	44,363	0.53%
RCR Air LLC	Air Transportation	7,641,734	42,794	0.51%
Total		\$ 202,694,633	\$ 1,135,090	13.59%

Schedule of Top Ten Electric Customers for Fiscal Year Ended June 30, 2010

Customer	Type of Business	Consumption (kWh)	Amount Billed	% of Total Operating Revenue
City of Lexington	Government	12,417,744	\$ 1,116,021	2.50%
Davidson County Schools	Public School System	5,991,091	758,026	1.70%
Lexington Memorial Hospital	Hospital	8,456,540	654,872	1.47%
Davidson County	Government	5,660,020	584,690	1.31%
Lexington City Schools	Public School System	5,578,248	559,571	1.25%
Food Lion	Grocery Store Chain	6,637,361	471,771	1.06%
Linwood Inc.	Furniture	6,857,389	401,829	0.90%
Leggett & Platt Inc.	Furniture	3,731,618	367,817	0.82%
Windstream Communications	Communications	2,813,700	257,152	0.58%
Wal-Mart	Retail	5,004,545	229,746	0.52%
Total		63,148,256	\$ 5,401,495	12.11%

Schedule of Top Ten Water Customers for Fiscal Year Ended June 30, 2010

Customer	Type of Business	Consumption (CCF)	Amount Billed	% of Total Water and Wastewater Operating Revenue
PPG Industries	Glass Products	214,395	\$ 491,081	6.41%
Kimberly Clark Corp.	Tissue Products	48,494	80,982	1.06%
Parkdale Mills	Textiles	32,226	54,359	0.71%
City of Lexington	Government	20,670	52,508	0.69%
Davidson County	Government	16,272	38,549	0.50%
Lexington Housing Authority	Public Housing	18,483	36,045	0.47%
Lexington Memorial Hospital	Hospital	20,244	35,999	0.47%
NC Department of Corrections	Prison	17,943	29,333	0.38%
Lexington City Schools	Public School System	7,945	27,462	0.36%
Cardinal Container	Corrugated Fiber Boxes	6,296	21,947	0.29%
Total		402,968	\$ 868,265	11.34%

Schedule of Top Ten Wastewater Customers for Fiscal Year Ended June 30, 2010

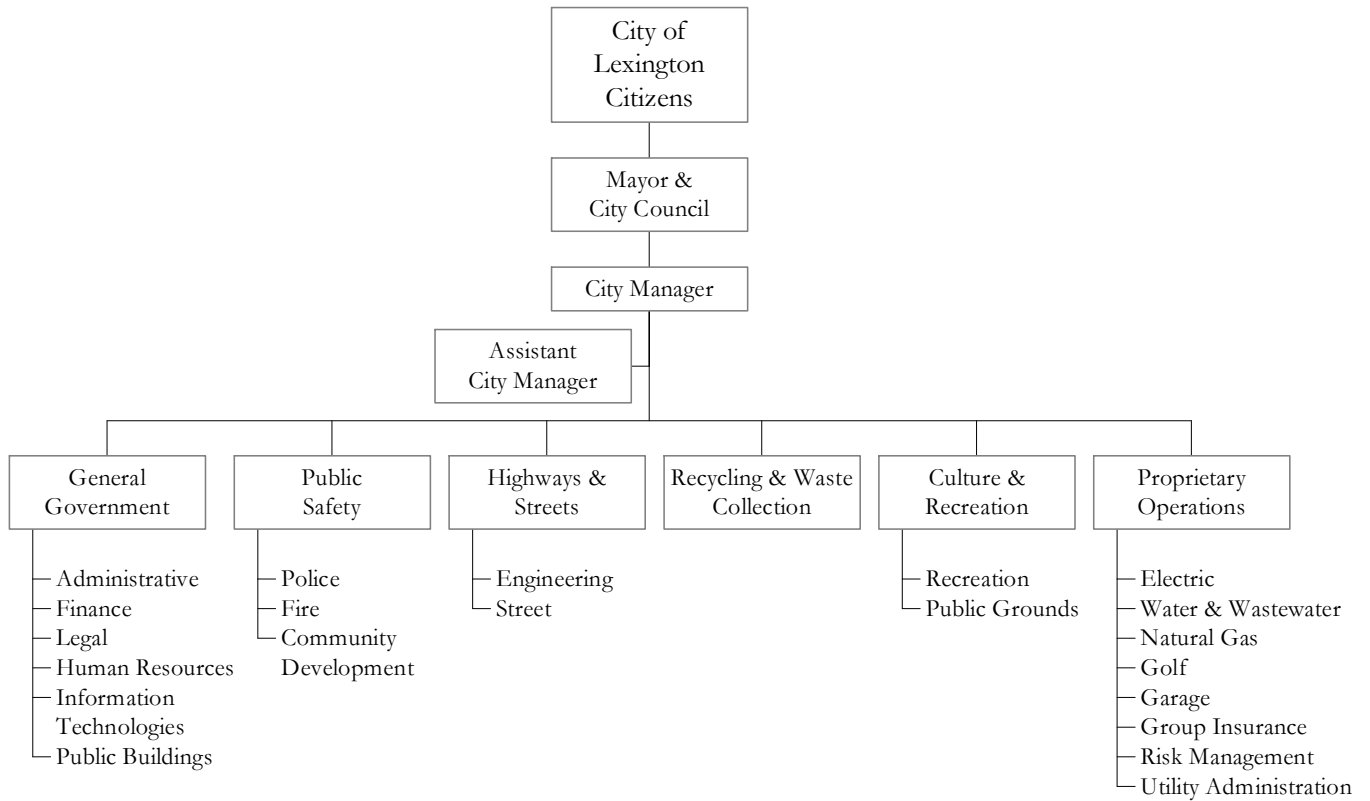
Customer	Type of Business	Consumption (CCF)	Amount Billed	% of Total Water and Wastewater Operating Revenue
Davidson County Schools	Public School System	22,731	\$ 149,498	1.95%
Atrium Companies Inc.	Vinyl Windows & Doors	12,928	76,702	1.00%
Lexington Memorial Hospital	Hospital	20,244	63,113	0.82%
Lexington Housing Authority	Public Housing	18,483	60,969	0.80%
Davidson County	Government	16,121	60,102	0.78%
Kimberly Clark Corp.	Tissue Products	27,035	54,935	0.72%
NC Department of Corrections	Prison	17,943	53,402	0.70%
Cardinal Container	Corrugated Fiber Boxes	12,545	45,230	0.59%
Brookstone Rest Home	Rest Home	7,089	40,496	0.53%
Parkdale Mills Inc.	Textiles	12,003	39,887	0.52%
Total		167,122	\$ 644,334	8.41%

Schedule of Top Ten Natural Gas Customers for Fiscal Year Ended June 30, 2010

Customer	Type of Business	Consumption (DT)	Amount Billed	% of Total Operating Revenue
Kimberly Clark Corp.	Tissue Products	162,080	\$ 1,374,400	9.14%
J E Jones Lumber Company	Lumber Dry Kiln	64,703	532,356	3.54%
PPG Industries (1)	Glass Products	604,918	515,909	3.43%
Lexington Memorial Hospital	Hospital	42,992	355,226	2.36%
Matcor Metal Fabrication	Machine Tools	32,522	305,667	2.03%
Leggett & Platt Inc.	Furniture	25,761	295,833	1.97%
Hanes Construction Co.	Paving	25,073	194,145	1.29%
Lexington City Schools	Public School System	12,910	156,036	1.04%
JELD-WEN	Windows and Doors	14,920	156,025	1.04%
Davidson County Schools	Public School System	10,789	130,944	0.87%
Total		996,668	\$ 4,016,541	26.71%

Note: (1) Transport only customer

City of Lexington, North Carolina Organizational Chart

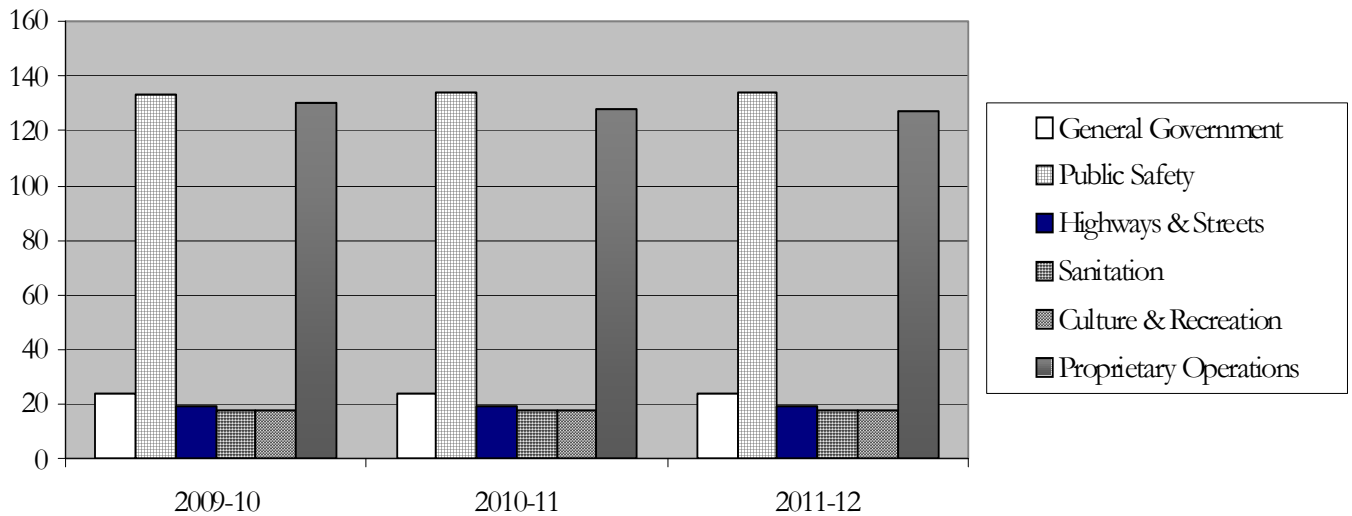


List of Principal Officials

May 5, 2011

City Manager	John L. Gray
Assistant City Manager	J. Alan Carson
City Clerk	Sara S. Lanier
City Attorney	Phyllis S. Penry
Director of Finance/Information Technologies	Terra A. Greene
Director of Human Resources	J. Alan Carson
Police Chief	John E. Lollis
Fire Chief	Phillip S. Hartley
Director of Community Development	Tammy V. Kepley
Recycling and Waste Collection Superintendent	Tammy E. Michael
Director of Parks and Recreation	A. Bruce Davis
Director of Public Services	Richard L. Comer
Water Resources Superintendent	Roger A. Spach
Director of Public Utilities	Chris C. Smith
Golf Director/Pro	James J. Fashimpaur
Garage Superintendent	Dirk W. Apt
Director of Customer Service	S. Dale Odom, Jr.

CITY OF LEXINGTON
PERSONNEL POSITIONS



Function	2009-10 Budgeted Full Time	2010-11 Budgeted Full Time	2011-12 Budgeted Full Time
General Government			
Administrative	5	5	5
Finance	10	10	10
Human Resources	2	2	2
Information Technologies	5	5	5
Public Buildings	2	2	2
Public Safety			
Police	79 ⁽¹⁾⁽²⁾	79 ⁽²⁾	79 ⁽²⁾
Fire	48	48	48
Community Development	6	7	7
Highways & Streets			
Engineering	4	4	4
Street	15	15	15
Sanitation			
Recycling & Waste Collection	18	18	18
Culture & Recreation			
Recreation	6	6	6
Public Grounds	12	12	12

CITY OF LEXINGTON
PERSONNEL POSITIONS

Function	2009-10 Budgeted Full Time	2010-11 Budgeted Full Time	2011-12 Budgeted Full Time
Proprietary Operations			
Electric	25	24	23
Water & Wastewater	44	44	44
Natural Gas	21	22	21
Golf	6	5	5
Garage	7	7	7
Risk Management	2	2	2
Utility Administration	25	24	24
Total	342	341	339

⁽¹⁾ 1 Gang Detective funded by Governor's Crime Commission grant for fiscal year 2009-10. Grant expired June 30, 2010.

⁽²⁾ 1 COPS Officer funded by U.S. Department of Justice grant for fiscal years 2009-10, 2010-11 and 2011-12. Grant expires June 30, 2012.

1 Traffic Officer funded by Governor's Highway Safety Program grant for fiscal years 2009-10, 2010-11 and 2011-12. Grant expires September 30, 2012.

BUDGET STRUCTURE AND PROCESS

GOAL SETTING AND BUDGET PROCESS

The City Council and management team meet in the early part of each calendar year at an annual retreat held for the purpose of establishing goals and priorities for the City. During the retreat, the Five Year Financial Planning Model is presented to the City Council. This financial model incorporates revenue trends and describes each department's operational and capital needs citywide for the next five years, along with the related costs and financial impact of selecting various levels of municipal services for the citizens of Lexington. As part of the retreat, City Council begins the process of adopting formal goals in strategic areas; these goals can be either multi-year goals or annual goals. These strategic goals guide the development of the budget for the upcoming year. These City Council goals are outlined in the City Manager's budget message.

The Finance Department staff prepares and distributes the budgetary request forms in accordance with the budget calendar. Upon return of the completed forms, the City Manager and budget team meet with each Department Head to review service levels and the respective budget requests along with detailed justifications. The City Manager and budget team then evaluate each department's zero based requests for personnel, operational items, and capital outlay. The evaluation process is detailed and time-consuming. For each department, every line item justification is reviewed in light of the departmental goals and needs and compared to current funding levels and the requests made during the update of the Five Year Financial Planning Model. Any requests for additional personnel must be justified by the department and then reviewed by Human Resources for an independent recommendation on appropriate staffing levels. The City Manager and budget team modify departmental requests and ultimately reach a balanced budget.

The City Manager's recommended budget is prepared and presented to City Council at budget work sessions. City Council has the opportunity to make changes to the City Manager's recommended budget prior to the final budget being prepared, which ultimately becomes City Council's budget and policy statement for the upcoming fiscal year. Once the budget is in its final form, a public notice is published for a public hearing on the budget. During the public hearing, citizens are given the opportunity to speak to the City Council about the proposed budget. The City Council has the option of making recommended changes to the final budget pending any discussion at the public hearing. The City Council then adopts the budget through the passage of an ordinance at a public meeting prior to July 1st.

The City of Lexington's adopted budget document is accessible for downloading through the City's web site at www.lexingtonnc.net.

BUDGET SCHEDULE

January 12	Budget calendar is presented to City Council
January 26	Department Heads receive budget preparation forms at staff meeting
January 31	Letters are issued to local non-profit agencies indicating due dates and needed information in order to request grant funding from the City
February 11	Personnel requests are due from Department Heads
February 16	Revenue budgets and fee change requests are due from Department Heads
February 21	Program objectives, performance measures, and organizational charts are due from Department Heads
February 22-23	City Council Retreat
February 25	Expenditure budget requests are due from Department Heads
February 28	Agency grant requests are due to the City
March 17-23	Budget hearing meetings with Department Heads and budget team
March 24-April 15	Budget team reviews and balances the proposed budget
April 18-May 2	City Manager's recommended budget is prepared
May 3, 5, 6	Budget work sessions with City Council and budget team
May 9	Budget is balanced
May 10-20	City Council's budget is prepared
May 23	City Council's budget is presented at City Council meeting to call for public hearing on the budget
June 2	Publish notice for public hearing
June 13	Public hearing is held and adoption of budget at City Council meeting
June 27	Additional meeting for City Council to adopt budget (if necessary)

BASIS OF BUDGETING

The City's annual balanced budget is adopted as required by the North Carolina General Statutes. All budgets are prepared using the modified accrual basis of accounting, as is described in the financial reporting systems section of this document. The budget ordinance must be adopted by July 1st of the new fiscal year; otherwise, the governing board must adopt an interim budget that covers that period of time until the annual ordinance can be adopted.

BUDGETARY CONTROL

Budgetary control is an essential element of governmental accounting and reporting. The City Council is required by state law to adopt an annual balanced budget for all funds and to utilize "encumbrance accounting" as defined in the statutes. Budgetary control is maintained at the departmental level by the encumbrance of estimated purchase amounts prior to the release of purchase orders to vendors. Open encumbrances lapse at yearend and are reinstated against the subsequent year's budget. They are shown as a restriction of fund balance in the Comprehensive Annual Financial Report (CAFR) for the governmental funds. Appropriations are made at the departmental level and amended as necessary. All annual appropriations lapse at the fiscal yearend. The City Manager or his designee is authorized to transfer budgeted amounts within departments; however, any revisions that alter the total expenditures of any department or fund must be approved by the City Council. In addition, the City Council must authorize the purchase of a capital item valued at \$10,000 or more that was not previously approved, approve the use of contingency funds, and grant a salary increase or create a position not duly authorized by the existing personnel policy or City Council action.

BUDGET STRUCTURE

The City's budget is divided into funds. Within each fund, there are separate departments with various individual budgets. The Annual Budget is adopted at the department level. An annual budget is adopted for the General, Controlled Substance Tax, Special Tax District, Electric, Water and Wastewater, Natural Gas, Golf, Garage, Group Insurance, Risk Management, Utility Administration, Capital Reserve, and Rate Stabilization funds. Additional funds are presented in the City's CAFR. These additional funds are comprised of multi-year capital and grant project funds for which annual budgets are not adopted; rather an ordinance is adopted for the life of the project. In addition, the CAFR may present funds with balance sheet and income statement activity for which no budget is adopted and no expenditures are made.

DESCRIPTION OF BUDGETED FUNDS

The City of Lexington's budget consists of 2 basic fund types: Governmental Funds and Proprietary Funds.

Governmental Funds are used to account for general government services such as Police, Fire, and Recycling and Waste Collection, which are generally supported by taxes, intergovernmental revenues, and limited user fees. The governmental funds include the General Fund and Special Revenue Funds. Special Revenue Funds account for specific revenue sources that are legally restricted or committed to expenditures for specified purposes.

Proprietary Funds are made up of 2 fund types: Enterprise Funds and Internal Service Funds. Enterprise Funds are used to account for operations that are financed and operated in a manner similar to private business enterprises, where the intent of the governing body is that the costs of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes. Internal Service Funds are used to account for services provided by one city department to other city departments. A listing and description of the City's annually budgeted funds follows.

GOVERNMENTAL FUNDS:

General Fund - The General Fund is the principal operating fund of the City. The General Fund accounts for all financial resources except those that are accounted for in another fund. The primary revenue sources are ad valorem taxes, intergovernmental revenues, limited user fees, and transfers from Enterprise Funds. The primary expenditures are for general government services, public safety, highways and streets, recycling and waste collection, culture and recreation, economic and physical development, and debt service.

SPECIAL REVENUE FUNDS:

Controlled Substance Tax Fund – The Controlled Substance Tax Fund is used to account for monies received from federal and state sources that are restricted for public safety use.

Special Taxing District Fund – The Special Taxing District Fund is used to account for the additional ad valorem property tax levied by the City, collected and contributed to Uptown Lexington, Inc. for the revitalization of the uptown district.

PROPRIETARY FUNDS:

ENTERPRISE FUNDS:

Electric Fund – The Electric Fund is used to account for the operation of providing electric service to customers. This includes all operating, debt service, and capital improvements associated with providing the service.

Water and Wastewater Fund – The Water and Wastewater Fund is used to account for the operation of providing water and wastewater service to customers. This includes all operating, debt service, and capital improvements associated with providing the service.

Natural Gas Fund – The Natural Gas Fund is used to account for the operation of providing natural gas service to customers. This includes all operating, debt service, and capital improvements associated with providing the service.

Golf Fund – The Golf Fund is used to account for the operation of the City's golf course. This includes all operating, debt service, and capital improvements associated with the course.

INTERNAL SERVICE FUNDS:

Garage Fund – The Garage Fund is used to account for the accumulation and allocation of costs associated with maintaining the City’s fleet of vehicles and equipment.

Group Insurance Fund - The Group Insurance Fund is used to account for the self-insurance costs associated with providing health and dental benefits to retirees of the City, employees of the City, and their dependents.

Risk Management Fund - The Risk Management Fund is used to account for the City’s self-retention costs and for the premiums on the City’s reinsurance program pertaining to workers compensation, property, and liability exposures.

Utility Administration Fund - The Utility Administration Fund is used to account for administrative overhead costs, which are shared by all of the utility enterprise funds and the General Fund such as administrative supervision of the utilities, billing and collections, customer service, meter reading, warehouse, and marketing the utilities.

Capital Reserve Fund - The Capital Reserve Fund is used to account for the accumulation of resources for future capital needs in the Electric, Water and Wastewater, Natural Gas, and Garage Funds.

Rate Stabilization Fund - The Rate Stabilization Fund is used to account for the accumulation of resources to mitigate future retail rates for customers of the Electric and Natural Gas utilities.

FINANCIAL REPORTING SYSTEMS

FUND ACCOUNTING

The accounts of the City are organized and operated on the basis of funds. A fund is an independent fiscal and accounting entity with a self-balancing set of accounts comprised of assets, liabilities, fund equity, revenues, and expenditures or expenses as appropriate. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with finance-related legal and contractual provisions. The minimum number of funds is maintained consistent with legal and managerial requirements.

MEASUREMENT FOCUS AND BASIS OF ACCOUNTING

The measurement focus and basis of accounting determines when the revenues and expenditures or expenses and the related assets and liabilities are recognized and reported in the financial statements.

Governmental Funds are reported in the CAFR using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recognized when measurable and available to pay the liabilities of the current period. In general, the City considers revenues available if they are collected within 60 days after yearend. Expenditures are recorded when the related fund liability is incurred; except for principal and interest on general long-term debt, claims and judgments, compensated absences, and other postemployment benefits, which

are recognized as expenditures when they are due. General capital asset acquisitions are reported as expenditures in governmental funds. Proceeds from general long-term debt and installment purchase contracts are reported as other financing sources.

Proprietary Funds are reported in the CAFR using the economic resources measurement focus and the accrual basis of accounting. The generally accepted accounting principles used in these funds are similar to those applicable to private sector businesses where the focus is upon determination of net income, financial position, and cash flows. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place.

DEPARTMENT AND PROGRAM MATRIX FOR FY 2011-12 BUDGET

	General Government	Public Safety	Highways and Streets	Recycling and Waste Collection	Culture and Recreation	Economic Development	Utilities
General Fund:							
Governing Board	X	X	X	X	X	X	X
City Manager	X	X	X	X	X	X	X
General Administration	X	X	X	X	X	X	
Finance	X	X	X	X	X	X	X
Legal	X	X	X	X	X	X	X
Human Resources	X	X	X	X	X		X
Information Technologies	X	X	X	X	X	X	X
Public Buildings	X	X	X	X	X	X	X
Police		X					X
Fire		X					
Community Development		X				X	
Engineering	X		X	X	X	X	X
Street			X				X
Recycling and Waste Collection				X			
Recreation					X		
Public Grounds	X	X	X	X	X	X	X
Lease/Bond Debt	X	X		X	X		
Other Financing Uses					X	X	
Special Revenue Funds:							
Controlled Substance Tax Fund		X					
Special Tax District Fund						X	
Enterprise Funds:							
Electric Fund							X
Water and Wastewater Fund							X
Natural Gas Fund							X
Golf Fund					X		
Internal Service Funds:							
Garage Fund	X	X	X	X	X		X
Group Insurance Fund	X	X	X	X	X		X
Risk Management Fund	X	X	X	X	X		X
Utility Administration Fund				X			X
Capital Reserve Fund	X	X	X	X	X		X
Rate Stabilization Fund							X

City of Lexington, North Carolina
Total Budget Summary

	General Fund	Special Revenue Funds	
		Controlled Substance Tax Distribution	Special Taxing District
Beginning Estimated Unreserved Fund Balance/Net Assets	\$ 5,651,545	\$ 1,429,109	\$ -
Estimated Revenues:			
Ad Valorem Taxes	7,858,324	-	85,310
Other Taxes	237,913	-	-
Unrestricted Intergovernmental	4,747,062	-	-
Restricted Intergovernmental	668,080	-	-
Permits and Fees	177,866	-	-
Sales and Services	965,162	-	-
Administrative Charges	1,973,447	-	-
Interest	40,600	-	-
Miscellaneous	54,900	-	-
Other Operating	-	-	-
Other Nonoperating	-	-	-
Total Estimated Revenues	<u>16,723,354</u>	<u>-</u>	<u>85,310</u>
Appropriations:			
General Government	5,131,448	-	-
Public Safety	8,860,129	818,488	-
Highways and Streets	2,171,607	-	-
Recycling and Waste Collection	1,786,262	-	-
Culture and Recreation	1,419,441	-	-
Economic Development	5,692	-	85,310
Cost of Sales and Services	-	-	-
Purchases for Resale	-	-	-
Administrative Charges	-	-	-
Capital Outlay	169,828	308,202	-
Debt Service:			
Principal Retirement	574,764	-	-
Interest and Fees	162,933	-	-
Total Appropriations	<u>20,282,104</u>	<u>1,126,690</u>	<u>85,310</u>

City of Lexington, North Carolina
Total Budget Summary

Enterprise Funds

Electric Fund	Water & Wastewater Fund	Natural Gas Fund	Golf Fund
\$ 34,750,240	\$ 39,030,051	\$ 18,792,593	\$ 371,138
-	-	-	-
-	-	-	-
-	11,986	33,960	-
-	-	-	-
47,120,628	8,418,427	14,035,063	748,876
-	-	-	-
40,000	19,200	18,399	250
-	-	-	-
1,505,483	176,600	25,000	-
5,000	-	8,882	-
<u>48,671,111</u>	<u>8,626,213</u>	<u>14,121,304</u>	<u>749,126</u>
-	-	-	-
-	-	-	-
-	-	-	-
-	-	-	-
-	-	-	-
4,731,113	5,666,241	2,587,138	696,936
40,339,915	-	8,529,149	-
1,677,960	1,153,933	1,220,807	11,699
18,540	8,000	12,500	18,126
-	-	-	-
530,222	794,867	453,278	149,245
188,938	197,933	227,158	41,704
<u>47,486,688</u>	<u>7,820,974</u>	<u>13,030,030</u>	<u>917,710</u>

City of Lexington, North Carolina
Total Budget Summary

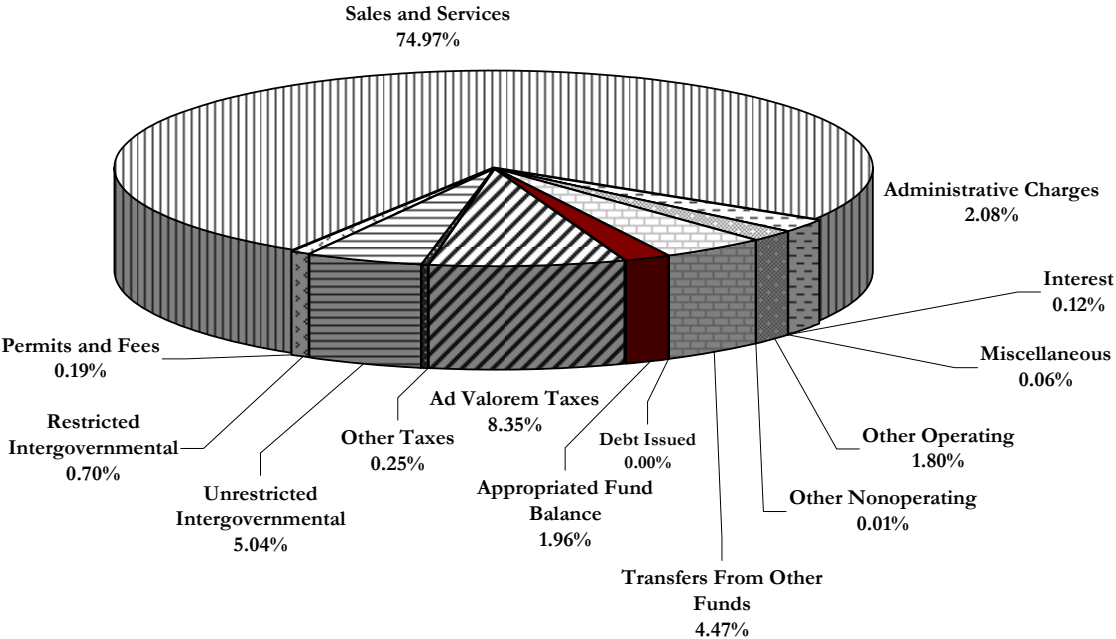
	General Fund	Special Revenue Funds	
		Controlled Substance Tax Distribution	Special Taxing District
Other Financing Sources (Uses):			
Transfers From Other Funds:			
General Fund	-	-	-
General capital projects fund	319,108	-	-
Electric Fund	1,350,000	-	-
Natural Gas Fund	832,602	-	-
Payment in Lieu of Taxes	530,584	-	-
Internal Service Funds:			
Capital Reserve Fund	-	-	-
Rate Stabilization Fund	-	-	-
Transfers to Other Funds:			
General Fund	-	-	-
Special Revenue Funds:			
Public Safety Grant	-	(5,000)	-
Economic Stimulus Grant	(39,400)	-	-
Special Taxing District	-	-	-
General Capital Projects Fund	-	-	-
Electric Construction in Progress Fund	-	-	-
Water & Wastewater Construction in Progress Fund	-	-	-
Natural Gas Construction in Progress Fund	-	-	-
Golf Fund	(168,584)	-	-
Payment in Lieu of Taxes	-	-	-
Internal Service Funds:			
Utility Administration Fund	-	-	-
Capital Reserve Fund	-	-	-
Rate stabilization fund	-	-	-
Installment Purchase Debt Issued	-	-	-
Total Other Financing Sources (Uses)	<u>2,824,310</u>	<u>(5,000)</u>	<u>-</u>
Budgeted Increase (Decrease) in Fund Balance/Net Assets	<u>(734,440)</u>	<u>(1,131,690)</u>	<u>-</u>
Ending Estimated Unreserved Fund Balance/Net Assets	<u>\$ 4,917,105</u>	<u>\$ 297,419</u>	<u>\$ -</u>

City of Lexington, North Carolina
Total Budget Summary

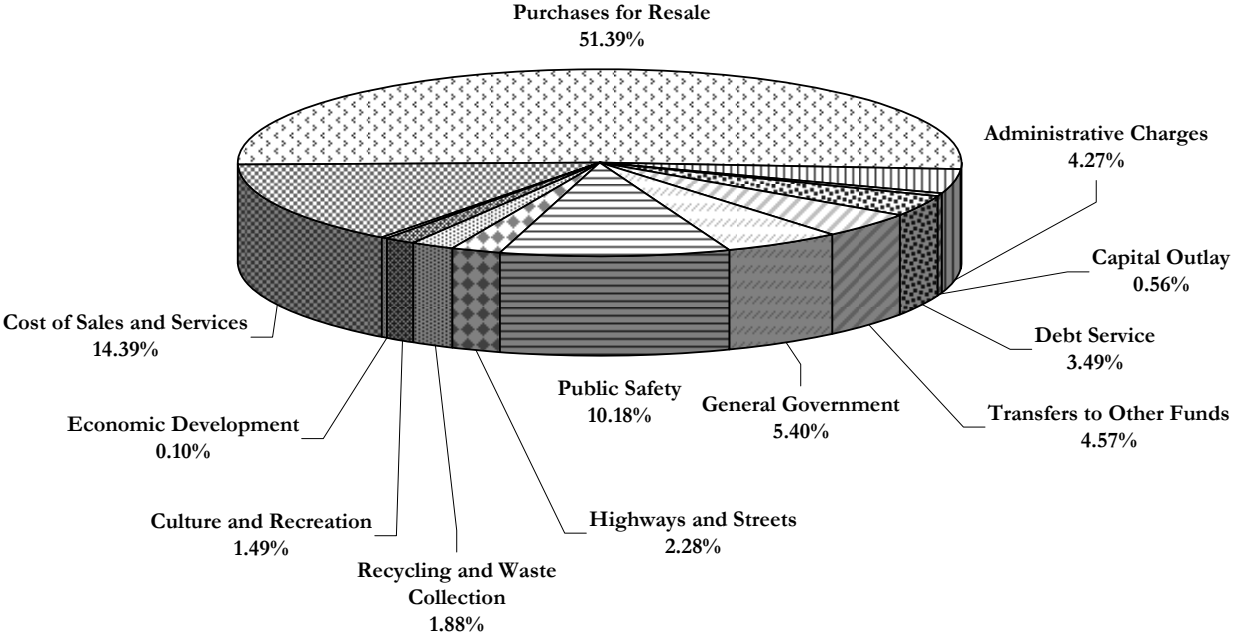
Enterprise Funds

Electric Fund	Water & Wastewater Fund	Natural Gas Fund	Golf Fund
-	-	-	168,584
-	-	-	-
-	-	-	-
-	-	-	-
550,000	-	-	-
500,000	-	-	-
(1,350,000)	-	(832,602)	-
-	-	-	-
-	-	-	-
-	-	-	-
-	-	-	-
(550,000)	-	-	-
-	-	-	-
-	-	-	-
-	-	-	-
(166,673)	(305,239)	(58,672)	-
(167,750)	(200,000)	(100,000)	-
-	(300,000)	-	-
-	-	(100,000)	-
-	-	-	-
<u>(1,184,423)</u>	<u>(805,239)</u>	<u>(1,091,274)</u>	<u>168,584</u>
-	-	-	-
<u>\$ 34,750,240</u>	<u>\$ 39,030,051</u>	<u>\$ 18,792,593</u>	<u>\$ 371,138</u>

CITY ESTIMATED REVENUES BY TYPE (Total Budget)



CITY APPROPRIATIONS BY TYPE (Total Budget)



**CITY OF LEXINGTON
MAJOR REVENUE ASSUMPTIONS FOR FISCAL YEAR 2011-12**

GENERAL FUND REVENUES

Ad Valorem Property Taxes:

Current Year Ad Valorem Property Taxes – Based on information provided by Davidson County, the government entity which bills and collects the City’s property taxes, the assessed valuation for the City is estimated to remain virtually unchanged for fiscal year 2011-12 at \$1.45 billion. Property tax collections remain down due to the local economy; therefore a 6.5% uncollectible rate was used in deriving the budget for property taxes. The property tax rate will remain the same at \$.56 per \$100 of assessed valuation.

Prior Year Ad Valorem Property Taxes – Based on historical trends and adjusted for the amount outstanding of the 2010 property tax receivable balance projected as of June 30, 2011.

Interest on Delinquent Ad Valorem Property Taxes – Based on historical trends and adjusted for the amount outstanding of the 2010 property tax receivable balance projected as of June 30, 2011.

Other Tax:

Occupancy Tax – The City is authorized by the NC General Statutes to collect an occupancy tax of 6% on gross revenues from hotel/motel room occupancy within the corporate limits. This tax is restricted for the use of promoting tourism activities. The revenue budget was derived based on historical trends of gross revenues for each hotel/motel.

Unrestricted Intergovernmental:

Local Option Sales Tax – The budget is based on estimates provided by the North Carolina League of Municipalities (NCLM) as well as current collections. The City is projecting a 12% decline due to the Census 2010 population reduction of 2,489 from the State 2009 Certified Population estimate figure of 21,420 used for revenue distribution purposes, which results in a decrease of \$392,000 from the fiscal year 2010-11 original budget projections.

Board of Alcoholic Control Distributions – The NC Statutes require the Board to distribute a portion of the profits to the City of Lexington. The budget was calculated based on historical trends.

Utility Franchise Tax, Telecommunications Sales Tax, and Piped Natural Gas Excise Tax – These taxes are levied by the State of NC. Both utility and telecommunications are levied based on the gross receipts of the companies operating in NC. The excise tax of piped natural gas is based on consumption by end users. The State of NC shares a portion of these revenues with municipalities based on sales and consumptions within each city. Local weather conditions, annexations, and any increases or decreases in local utility rates influence these revenue sources. For utility franchise tax, the City is budgeting virtually flat based on historical trends and information provided by the NCLM. The City is budgeting a slight decrease in telecommunications and natural gas compared to fiscal year 2010-11.

Telecommunications is expected to be less due to cellular phone competition; and the piped natural gas excise tax is highly sensitive to the weather. This information was also supplied by the NCLM.

Cable TV Franchise – Effective January 1, 2007, this revenue is now passed through the State of North Carolina, as a state tax on cable television and video services franchise, to local governments versus what has historically been a local franchise agreement. This law is intended to promote competition, establish uniform tax rates and lower cable rates while still providing local revenue. The City has historically held two local franchise agreements with Time Warner and Lexcom, now doing business as Windstream, and the revenue received by the City was 5% of the cable TV companies' gross revenues within the City limits. The new revenue base now distributed quarterly from the State is comparable to historical trends.

Restricted Intergovernmental:

Solid Waste Disposal Tax – Effective July 1, 2008, the State enacted a \$2 per ton solid waste disposal tax. Proceeds of the tax are distributed as follows: 50% to pay for remediation of pre-1983 landfills, 18.75% to cities on a per capita basis for solid waste management programs, 18.75% to counties for solid waste management programs, and 12.5% to the Solid Waste Management Trust fund for grants for local governments and state agencies. The revenue for fiscal year 2011-12 is flat based on the trends recognized in fiscal year 2010-11.

Powell Bill – The City receives funding for street maintenance through the State of North Carolina's Powell Bill Fund, which is allocated 75% based on population and 25% based on city maintained street mileage. The budget for this revenue was calculated based on historical trends and information provided by the NCLM. The revenue is 4.5% less than the amount received in fiscal year 2010-11 due to the 12% Census 2010 population reduction of 2,489 from the State 2009 Certified Population estimate figure of 21,420 used for revenue distribution purposes, mitigated by the volume of motor fuel being taxed with current economic conditions.

Permits and Fees:

Inspections and Permits – Based on existing and proposed changes to user charges and projected commercial and residential development as well as historical trends.

Sales and Services:

Recycling and Waste Collection – Based on existing user charges for residential and a 10% vacancy rate from the traditional level of customers for collection of residential and commercial solid waste.

Cemetery – Based on existing user charges and the projected burials and graves sold as indicated by historical trends.

Recreation – Based on projected activities, participation, and fees from existing user charges.

Administrative Charges:

Interfund Revenues – Based on estimated expenditures for services provided by General Fund departments that are reimbursed by the Electric, Water and Wastewater, and Natural Gas Funds. These expenditures are the sum of the estimated percentage of time and resources each General Fund department expends on behalf of the respective utility funds. These amounts are calculated annually.

Interest:

Interest Earned on Investments – Based on estimated cash balances during fiscal year 2011-12 and estimated interest rates. Still recovering from the economic recession, interest rates are expected to remain relatively flat in the coming budget year. Thus, the City has budgeted essentially the same revenue as compared to the fiscal year 2010-11 original budget.

Other Financing Sources:

Installment Purchase Revenues – The City has no plans to debt finance equipment in the coming budget year.

Transfer from the Electric Fund – The City has budgeted to transfer \$1.35 million from the Electric Fund to the General Fund to balance the budget. This amount remains constant with the funding provided in fiscal year 2010-11. The maximum transfer allowed based on a formula provided by the NC State Treasurer is approximately \$1.7 million. This calculation based on the formula is an amount not to exceed 3% of electric's gross capital assets.

Transfer from the Natural Gas Fund – The City has budgeted to transfer \$832,602 from the Natural Gas Fund to the General Fund to balance the budget. This represents an increase of \$31,173 as compared to fiscal year 2010-11. Current expansion activity in the Natural Gas Fund, which has increased the value of the capital assets and infrastructure, has ultimately enabled an increase in the transfer amount. The calculation based on the formula provided by the NC State Treasurer is an amount not to exceed 3% of natural gas's gross capital assets, which equals \$832,602 for Natural Gas.

Payment in Lieu of Taxes from the Electric, Water and Wastewater, and Natural Gas Funds – The utility funds pay the General Fund an amount equal to the value of their respective capital assets within the city limits multiplied by the property tax rate.

Appropriated Fund Balance – Every effort is made to maintain a stable or reduced level of fund balance appropriations. The City is budgeting \$734,440 in fund balance in order to balance the fiscal year 2011-12 budget. This is an increase of \$54,925 as compared to the fiscal year 2010-11 original budget. Appropriations of fund balance to balance the budget is limited to cash and cash equivalents less current claims against that cash. The statutory formula is cash and investments minus the sum of liabilities, encumbrances, and deferred revenues arising from cash receipts.

SPECIAL REVENUE FUND REVENUES

Ad Valorem Property Taxes:

Current Year Ad Valorem Property Taxes – Based on information provided by Davidson County, the government entity which bills and collects Uptown’s property taxes, the assessed valuation for the Special Tax District is estimated to remain stable at \$44.9 million for fiscal year 2011-12. Property tax collections remain down due to the local economy; therefore a 5% uncollectible rate was used in deriving the budget for property taxes. The property tax rate for the Special Tax District will remain at \$.20 per \$100 of assessed valuation for fiscal year 2011-12.

GENERAL CAPITAL PROJECT FUND REVENUES

Sales and Services:

Property Rental – Funding derived from leasing warehouse space to Lexington Home Brands and Carolina Apparatus Repair and Service is included in the amount of \$89,167, to be used for expenditures associated with the LFI, Inc. Plant One property redevelopment.

ELECTRIC FUND REVENUES

Due to the aftermath of the recession, the revenue budget is based on no anticipated growth in power consumption in the residential and commercial classes. In addition, Lexington’s industrial consumptions remain very low due to significant losses in industrial load from manufacturing plant closings since 2001. Finally, the consumptions have been lowered and weather normalized from the extraordinarily cold winter of fiscal year 2010-11.

Electric rates across all customer classes of residential, commercial and industrial have been increased by an average of 5% effective July 1, 2011. This adjustment in rates is necessary due to the North Carolina Municipal Power Agency No. 1 (NCMPA1) passing on a 5% wholesale power cost increase that affects Lexington by approximately 6% because of the industrial load loss and a reduction in wholesale credits received from NCMPA1.

Beginning in July of 2009, a surcharge is now being applied and modified annually to every electric customer’s bill in order to recoup the proceeds necessary to comply with the State enactment of Renewable Energy Portfolio Standards (REPS). This legislation is an environmental provision to require 10% renewable energy sources such as solar and wind in the NCMPA1 energy portfolio by 2018. The modified surcharges effective July 1, 2011 of \$5.04 per year for residential, \$26.52 per year for commercial, and \$257.04 per year for industrial customers are projected to generate \$148,338.

WATER AND WASTEWATER FUND REVENUES

Consumption estimates are factored in to budget the water and wastewater revenues. Consumption for water and wastewater is budgeted flat for all customer classes due to voluntary conservation, the aftermath of the economic recession, and industrial load loss from plant closings. To meet unfunded State mandates and provide reliable plant operations, a 2.5% water and 5% wastewater rate increase is proposed which will affect all customer classes. The rate increase will become effective July 1, 2011.

NATURAL GAS FUND REVENUES

The revenue budget is based on adding 364 residential equivalents due to customer base growth in areas of the City and Davidson County where natural gas lines have been extended in recent years. Consumption estimates have been weather normalized to reflect typical warmer winter weather trends, down from the extraordinarily cold winter of fiscal year 2010-11, and are based on historical trends and anticipated customer growth as it relates to natural gas consumption in the residential, commercial and industrial classes. Adversely impacting the revenue budget are the dwindling consumptions from the recession and plant closings in recent years.

The City is not changing the base rate charged to natural gas customers; and the cost of gas component is budgeted lower at \$6 per dekatherm next budget year, compared to \$7.75 budgeted in fiscal year 2010-11.

GOLF FUND REVENUES

The revenue budget is based on a rebound in terms of rounds played, cart rentals, and municipal club rentals. The past three years of play at the course has suffered from the recession, an extraordinarily wet fall and winter of fiscal year 2009-10, and an extraordinarily hot and humid late summer of fiscal year 2010-11. To offset the debt payment for the golf course renovations, the General Fund subsidy to the Golf Fund has been budgeted at \$168,584 which is the same as compared to the fiscal year 2010-11 original budgeted transfer.

INTERNAL SERVICE FUND REVENUES

Charges for Sales and Services:

Interfund Revenues – Based on estimated expenditures for services provided by the Garage, Group Insurance, Risk Management, and Utility Administration departments that are reimbursed by other funds. These expenditures are the sum of the estimated percentage of time and resources each Internal Service Fund department expends on behalf of the respective general, enterprise, and internal service funds. These amounts are calculated annually.

CAPITAL RESERVE FUND REVENUES

Other Financing Sources:

Transfer from Water and Wastewater Fund – Funding set aside from Water and Wastewater operations into capital reserve that is restricted for future capital infrastructure replacements and expansions for the water and wastewater utility system, as well as to set aside reserves for the unfunded State mandate of Phase II Disinfection Byproduct at the water plant with a compliance deadline as early as October 2013.

Transfer from Garage Fund – Funding set aside from Garage to fund future vehicle and equipment needs for use by all City department.

DEBT INFORMATION

INSTALLMENT PURCHASES

The City enters into installment purchase agreements to finance purchases of capital outlay equipment, major capital items and construction of major capital facilities. Installment purchase agreements have been entered into for both general government and proprietary activities and are being repaid from the applicable resources. The debt is collateralized by a security interest in the property until the loan is liquidated.

GENERAL OBLIGATION (G.O.) BONDS

The City issues G.O. bonds to finance the purchase of major capital items and the acquisition and construction of major capital facilities. G.O. bonds have been issued for both general government and proprietary activities and are being repaid from the applicable resources. All G.O. bonds are collateralized by the full faith, credit, and taxing power of the City.

REVENUE BONDS

The City issues revenue bonds to finance the purchase of major capital items and the acquisition and construction of major capital facilities. Revenue bonds were issued for a natural gas system expansion in 1996 and in 2006. The revenue bonds are being repaid from the Natural Gas Fund. The City has been in compliance with the covenants as to rates, fees, rentals and charges in Section 704 of the Bond Order since its adoption in 1996. Section 704(a) of the Bond Order requires the debt service coverage ratio be no less than 120%. The debt service coverage ratio calculation for the year ended June 30, 2010 follows:

Operating Revenues	15,036,204
Operating Expenses*	12,462,162
Operating Income	2,574,042
Nonoperating Revenues (Expenses)**	68,062
Income Available for Debt Service	2,642,104
Revenue Bond Debt Service Principal and Interest Paid	834,370
Debt Service Coverage Ratio	317%

*Per rate covenants, this does not include the depreciation expense of \$527,124.

**Per rate covenants, this does not include revenue bond interest paid of \$169,219.

TOTAL OUTSTANDING DEBT PRINCIPAL AS OF JUNE 30, 2011

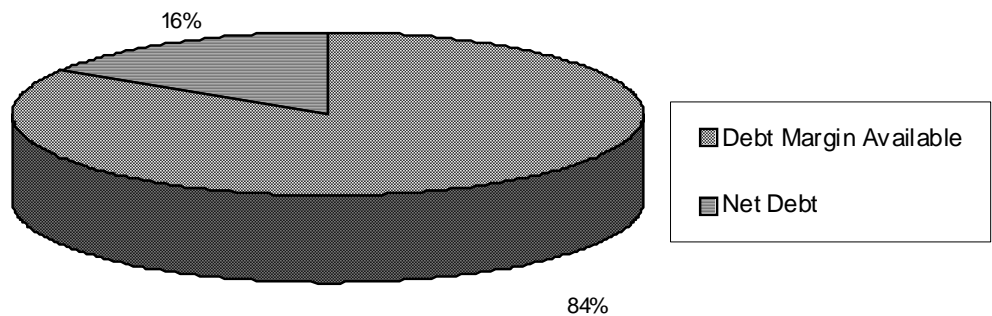
Fund	Installment Purchase	Bonds	Total Debt
General Fund	\$ 2,756,001	\$ 971,861	\$ 3,727,862
Electric Fund	4,392,847	1,149,846	5,542,693
Water & Wastewater Fund	3,134,749	3,121,293	6,256,042
Natural Gas Fund	2,010,145	2,834,318	4,844,463
Golf Fund	1,086,065	-	1,086,065
Total	\$ 13,379,807	\$ 8,077,318	\$ 21,457,125

LEGAL DEBT MARGIN AS OF JUNE 30, 2011

As demonstrated below, the City has maintained an ample legal debt margin. This margin is based on a debt limit of 8% of assessed valuation as required by North Carolina General Statute 159-55c. The margin allows for the issuance of new debt as described in the section below.

Assessed Valuation*	1,349,618,104
Debt Limit (8 percent of total assessed value)	<u>107,969,448</u>
Debt Applicable to Limitation (Gross Debt):	
Authorized and Outstanding G.O. Bonded Debt	5,243,000
Installment Purchase	13,379,807
Statutory Deductions:	
Electric G.O. Bonds	<u>(1,149,846)</u>
Total Debt Applicable to Limitation (Net Debt)	<u>17,472,961</u>
Legal Debt Margin Available	<u>\$90,496,487</u>

*Assessed valuation is presented per North Carolina Department of Revenue Form TR-2-10 2010 Municipal Certification of Valuation and Property Tax Levies for the Fiscal Year Ending June 30, 2011.



DEBT SERVICE BUDGET FOR FISCAL YEAR 2011-12

Fund	Installment Purchase		Bonds	
	Principal	Interest	Principal	Interest
General Fund	362,965	140,580	211,799	22,353
Electric Fund	367,460	162,491	162,762	26,447
Water & Wastewater Fund	358,426	126,143	436,441	71,790
Natural Gas Fund	219,996	108,472	233,282	118,686
Golf Fund	149,245	41,704	-	-
Garage Fund	13,088	149		
Total	\$ 1,471,180	\$ 579,539	\$ 1,044,284	\$ 239,276

PROPOSED DEBT

The City of Lexington currently anticipates issuing debt in the amount of \$500,000 in late FY 2010-11 or early FY 2011-12 for the purchase and upon delivery of a Fire Department pumper truck. This financing is anticipated to be issued at an interest rate of 4% or less for a repayment period of 10 years, with two estimated semi-annual debt payment budgeted in the amount of \$60,000.