

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.

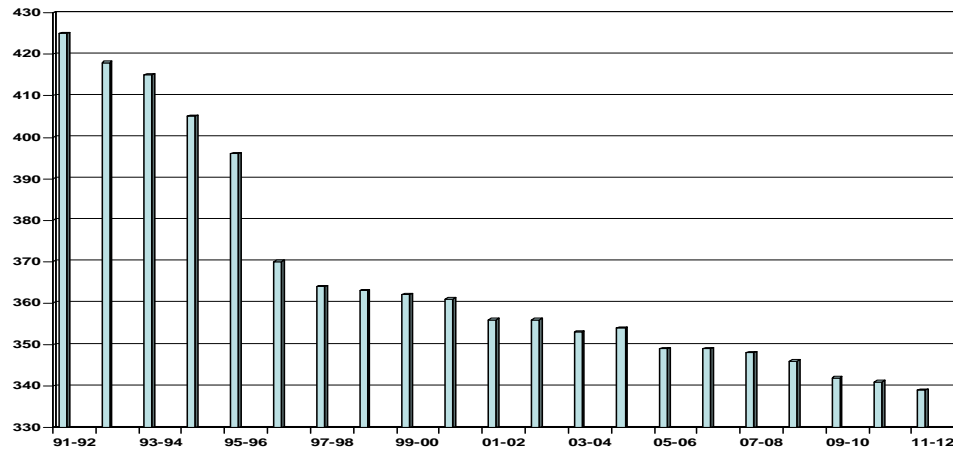
The proposed budget incorporates restructuring and consolidation of public utilities, public works, finance and information technologies, and fire and community development building safety inspection functions. As part of the restructuring efficiencies, the proposed budget contains the reclassification 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.

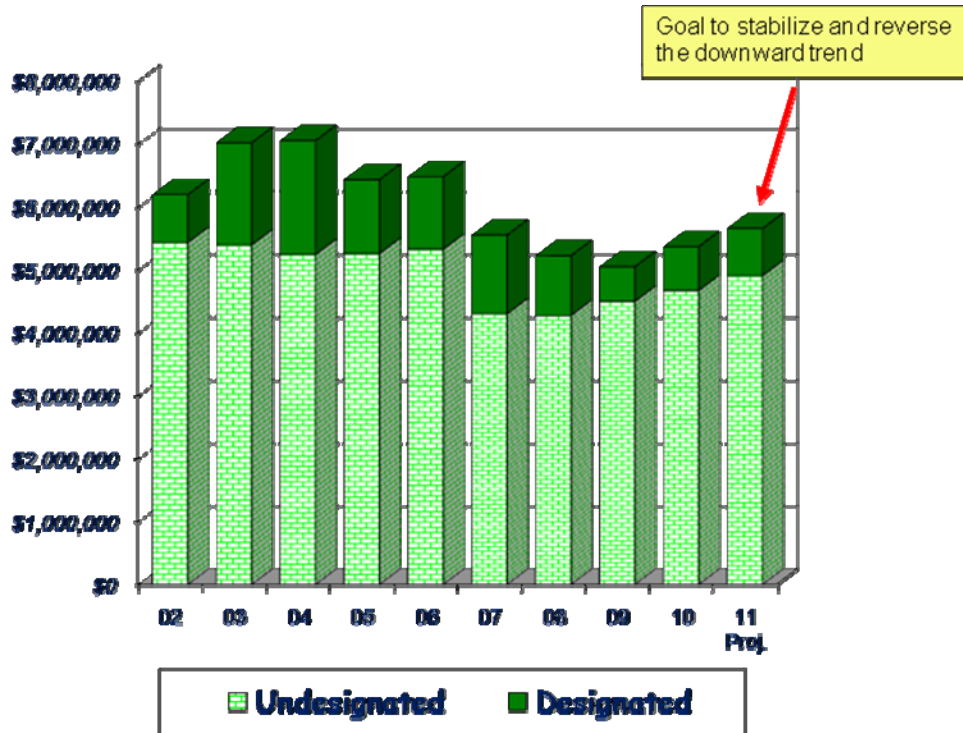
In the General Fund, the City will rely on a strong fund balance to cover any unexpected events or emergencies. The following table estimates available fund balance in the General Fund for next fiscal year.

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 recessional 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, flowing style.

John L. Gray
City Manager