

## CITY MANAGER'S BUDGET MESSAGE

May 23, 2016

Mayor and City Council  
City of Lexington, NC

Dear Mayor Clark and City Council Members,

In accordance with North Carolina General Statutes, I hereby present you with the fiscal year 2016-17 proposed budget for the City of Lexington. 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 Lexington City Council's goals and guiding principles for governing.

External events and recent law enforcement incidents across the United States are affecting the recruitment and retention of quality law enforcement officers in agencies across North Carolina and the United States. Both local and state agencies are affected by these events and the influence on the recruitment and retention of quality law enforcement officers, as well as additional equipment expectations such as body cameras. Class sizes in Basic Law Enforcement Training at local and contiguous community colleges have experienced a dramatic reduction in the number of students. The competitive recruitment and hiring of police officers from other agencies has increased. The City of Lexington Police Department is experiencing these adverse impacts resulting in a 17% turnover rate; thus, funding measures are incorporated in this budget to address law enforcement compensation and invest in modernized equipment.

In preparing the budget, moderate personnel, operational and utility reliability investments have been made, while simultaneously leveraging debt, grant and private donation opportunities to mitigate citizen and customer impacts. However, a use of cash reserves in the General Fund was necessary in order to maintain service levels and to incorporate the goals set by the Mayor and Council members at their annual retreat in February 2016, especially given the negative impact of the 2016 property revaluation. Of particular note, the proposed budget of \$97 million is down from the current year by a margin of \$1.8 million, which is generally due to electric wholesale rate savings with the recent debt restructuring by NC Municipal Power Agency #1; countered by additional General Fund revenues and fund balance cash reserves being directed towards City Council's goals and initiatives including strategic investments in the "Re-creation of Recreation" master plan and to address the emerging pressures in law enforcement. To ignite progress towards the long range enhancements of recreational facilities in Lexington, multi-year funding is included to purchase the building to be transformed into an indoor recreation center, debt service for the newly renovated Lexington Aquatic Park (former donated Hillside Pool) and for the renovation of Holt-Moffitt Field and Washington Park including a splash pad, and professional services to facilitate preliminary design and citizen involvement in the remaining phases of the recreation master plan. Revenues are also directed towards City Council's goal of green initiatives to finalize the final year of a four year phase-in of the residential recycling rollout program. In addition, the budget includes \$500,000 for street resurfacing projects, which is identical to current year levels of funding in the General Fund.

With the nationwide impact on local law enforcement creating \$550,000 compensation and equipment cost pressures and a recent property tax revaluation within the last year lowering real property values by approximately \$45 million, there is a proposed \$.05 increase in the property tax rate to \$.65 per \$100 of assessed valuation in the budget. Each penny on the tax rate generates approximately \$146,000. The budget includes transfers made to the General Fund from the Electric and Natural Gas Funds of \$1.25 million and \$972,049, respectively. The proposed budget maintains existing City service levels; while enhancing efforts to pursue green initiatives and simultaneously makes pivotal investments in recreation and continued economic development focus designed to rebuild Lexington's economy.

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. In the previous decade, the City suffered dramatic property tax and utility revenue losses from the closing of furniture and other manufacturing plants. These continuing impacts from industrial plant closings have reverberated throughout the City's budget long after the shut downs occurred. Since 2001, a total of twelve industrial plants closed and the City 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 62 cents. Despite some positive signals of recovery, such as a \$23 million constructed Save-A-Lot distribution center and MasterBrand Cabinets \$12 million investment in the industrial park and a recent uptick in residential and commercial development, equal economic replacement value remains in the distance for Lexington.

Beginning with fiscal year 2016-17, the City expects an estimated additional \$350,000 in local option sales tax due to a redistribution by the State of NC. This additional revenue source is earmarked for economic development activities. The City receives several State collected local revenues that are partially based on State per capita distribution models and remain relatively flat; those being the local option sales tax, beer and wine tax, and the Powell Bill gasoline tax which supports 31% of the City's street maintenance budget. On a positive note, utility sales tax revenues are expected to increase by approximately \$132,100 over the current year.

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 from November 2006 through July 2008. 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 the Uptown District of 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 had an effect on the City's financial flexibility and the task of redevelopment of the property continues to have financial impacts on City budgets. City Council appointed a commission of capable citizens to focus on the redevelopment of the LFI Plant 1 property whose work was completed in 2014, of which the comprehensive planning documents for the identified 'Depot District' are now being used to solicit business redevelopment and pave the way for passenger rail stop. Fortunately, the infusion of \$118,451 of rental income from leased warehouse space to tenants is included in the proposed budget to offset the costs of selective demolition, site preparation and redevelopment efforts in the Depot District. Recently, Bull City Ciderworks landed in 2015 as an anchor tenant and a \$200,000 donation from a local business in 2016 is igniting the construction of an amphitheater in the Depot District. In 2011, the City was awarded a \$700,000 federal grant to begin the planning phase of a multi-modal transportation station for a passenger rail stop in the Depot District which encompasses the LFI Plant 1 property; the final architectural plan report was made available in 2014 at public

workshops garnering the attention of then NC Department of Transportation Secretary Anthony Tata, with the grant closure occurring in 2016. These planning efforts are instrumental to seek additional funding assistance for construction of a rail stop platform.

## **OTHER MAJOR IMPACTS**

In addition to the local economy showing signs of recovery but remaining a bit sluggish, there are other factors that have posed a significant impact on the budget. Unfunded federal and state mandates in Natural Gas, Electric and Water and Wastewater have affected the City budget collectively by \$490,525. Due to a federal mandated Distribution Integrity Management Program in the natural gas industry, the City is incurring costs for public awareness and a natural gas system routine inspection and pipe replacement program. Over the course of the next few years, electric customers will continue to pay 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.

Weather and economic conditions have a profound impact on utilities' operating costs and revenues. Moderate winters, industrial load loss from plant closings, energy efficiency trends and drought conditions can affect utility rates to customers and create challenges projecting revenues for the utility funds for budgeting purposes. For example, industrial consumptions for City electric service have lowered by 82 million kWh or 74% since 2001. To compound customer rate pressures, the North Carolina Municipal Power Agency No. 1 (NCMPA1) has implemented multiple wholesale electric rate increases in the past several years. However in July 2015 and July 2016, electric customers received a 2.7% and will receive another 2% average retail rate decrease, respectively. The electric rate relief is made possible by NCMPA1 restructuring outstanding debt in June 2015, which relieved purchased power cost pressures to the City. The fixed wholesale power costs represent 79% of the electric utility budget; reinforcing the significant impact the wholesale rate received from NCMPA1 has on the City's financial inability to absorb cost increases. Future wholesale rate cost impacts to electric customers is also mitigated by the NCMPA1 continuing the transition to 'true up' the allocation of demand costs across the agency members over the course of several years between 2013 and 2021.

A total of nine partner agencies and commissions requested funding for Grants to Agencies totaling \$275,900, which was reduced to \$235,900 in the proposed budget but includes new partner funding to the Davidson County Transportation Fund to sustain the bus route in Lexington. The General Fund subsidy of \$318,584 for the golf course covers the annual debt service of \$168,584 for the course renovations and includes an additional infusion of \$150,000 for golf course maintenance and operations. These factors, plus the strategy implemented to address the nationwide impact on law enforcement, the recreation master plan, continued economic recovery and utility system reliability, account for the major differences between the current year budget and the proposed 2016-17 budget.

The Mayor and City Council have demonstrated leadership and vision in making investments in Lexington's new economy in the aftermath of financial challenges.

## **CITY MANAGER'S STRATEGY IN PREPARING THE PROPOSED BUDGET**

In preparing the proposed budget and analyzing the forces at play, answers to the following questions helped determine the general direction for the proposed budget:

- Can key investments in service levels and partnerships be made in the face of law enforcement adversity and economic challenges while continuing the City's progress forward?

- How can the budget framework fund City Council's goals and priorities and invest in a new economy and an improved quality of life with special emphasis on the "Re-creation of Recreation" master plan for City of Lexington citizens?
- How does the City strike a financially balanced approach to continue to jumpstart the new economic direction, further the City's brand and expedite development in the Depot District?
- What impact will the loss of revenue from the property tax revaluation have on the City's budget?
- What impact will unfunded federal and state mandates have on the City's budget?
- What impact will wholesale electric rates have on utility customers?
- How can the City implement critical utility system reliability maintenance with minimal impacts to customer rates?
- 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 City Council goals and 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 address City Council priorities, maintain and attract new jobs and investment while continue investing in public infrastructure where financially feasible; and restructuring government in order to find lasting 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 self-supporting 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 and leveraging the wastewater capacity asset for economic development strategic initiatives are of extreme importance to ensure service delivery and sustainability in the future.

In addition, staff continues to research investments in new technology to increase productivity and overall professional development of the workforce, ensure and improve customer service response, and lower or stabilize operating costs. Some restored level of investment is proposed to personnel pay and benefits, offset by strategic delayed funding for various full-time employees; all in an effort to enhance service levels in a struggling economy. The City has aggressively pursued and been successful in acquiring federal and state grants to help finance personnel, equipment and new initiatives; these resourceful efforts will definitely continue next year. It is important to note that the availability of drug forfeiture funds is virtually diminished due to legislative changes to the program.

The proposed 2016-17 budget is balanced with \$772,298 in fund balance, a decrease of \$520,524 from the current year. Fund balance, otherwise known as the City's General Fund savings account, is estimated to decrease by approximately \$1 million in the current year. The projected decrease to fund balance in the current year is primarily due to planned deficit spending towards the recreation master plan and unforeseen costs in construction projects, light replacements at Bingham Tennis Center and strategic investments to further Depot District redevelopment and passenger rail stop grant opportunities. Fund balance can be strategically used during disasters and difficult economic times to minimize impacts to citizens but must be preserved to maintain the financial integrity and debt credibility 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.

Only by the willingness to understand citizen needs, bridge services to meet the needs of the community, and possess the vision to pursue bold actions that can compete and rebrand the image of this City can we hope to restore economic health and quality of life to our community.

## **BUDGET INITIATIVES AND SERVICE ENHANCEMENTS**

Numerous short term and long term initiatives are funded in the 2016-17 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.

The City currently uses multiple platforms of antiquated technology to track critical work order cost of service information. Once a service order is generated, work orders are an internal accounting methodology used to aggregate the cost of the labor, materials and equipment used on public service and utility jobs. Work order cost information is imperative to request Powell Bill reimbursements and to maintain accurate asset values of the City's utility infrastructure. A comprehensive work order computerized system with funding of \$250,000 will be implemented in the coming budget year. Additional technological enhancements are included for sworn police officer body cameras, reservation software for parks and recreation services, and a water plant SCADA system upgrade for timely notifications with water line breaks in the amounts of \$15,000, \$20,000 and \$86,300, respectively.

City Council's goal of green initiatives will be realized in upcoming budget year 2016-17 with a \$105,000 investment included to expand the residential rollout recycling program to fulfill the final year of a four year phase-in period. On August 13, 2012, City Council accepted a State grant of \$12,600 for the City to implement a new automated rollout recycling program. The City matched the grant using revenues received through the Solid Waste Disposal Tax enacted in 2008 to purchase 500 95-gallon rollout containers to automate the program. Previously, the City primarily used 18-gallon bins. Most people who recycle regularly attest that their recycling has grown much larger than their garbage; thus, the need for the larger container and the need to automate. With the larger size of the rollout containers, collection is scheduled bi-weekly. With increased recycling efforts by citizens, the City can mitigate the cost of service by lowering landfill tipping fees. Four neighborhoods were included in the pilot program that was successfully implemented in January 2013. In January of 2014, 2015 and 2016, the City completed Thursday's, Friday's and Tuesday's collection routes, respectively. In upcoming budget year 2016-17, the City is expanding the program to include Wednesday's route which completes the program citywide.

In an effort to address a key City Council goal, a conceptual recreation master plan was introduced at the 2014 City Council retreat entitled the "Re-creation of Recreation." Key components of the vision to completely revamp recreational facilities and enhance participant recreational opportunities in Lexington are a result of the Parks and Recreation Facility Development Master Plan Study facilitated by Site Solutions in 2013, which included interactive public forums. Youth recreational opportunities in the community have been reiterated for over four decades and most recently reemphasized again by the citizen-led Strategic Planning Committee's *2020 Renaissance* plan. The "Re-creation of Recreation" master plan is recommended to be implemented over several years to mitigate the cost burden to citizens. The proposed 2016-17 budget includes \$105,000 funding to continue the five-year contract to purchase the building to be transformed into an indoor recreation center; \$53,941 debt service for the newly renovated Lexington Aquatic Park (former donated Hillside Pool) which opened in 2015; \$156,100 debt service for the renovation of Washington Park and Holt-Moffitt Field, with the scope of the splash pad improvements at Washington Park partially offset by a \$217,500 NC Parks and Recreation Trust Fund grant; and an estimated \$200,000 cash advance from the General Fund to begin preliminary design of the Radcliffe skate/bmx park and the indoor recreation center while facilitating

citizen involvement in the recreation master plan process for these new facilities. For more information, please visit the City's website at <http://www.lexingtonnc.gov/index.aspx?page=589>.

Given water main break activity over the last year, \$90,000 is included in the proposed budget to fund an engineering consultant to formally evaluate the integrity, reliability and any vulnerabilities of the water and wastewater system, as well as to identify future capital improvement needs and possible funding requirements with a rate study component. Grant funding is being sought to assist in this endeavor. The results of the study and ensuing funding strategy is identified as a priority to be reviewed for further action by City Council in future budget cycles.

Ultimately, seeking grant opportunities and making strategic investments in economic development, technological advancements and reengineering 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.

### **CAPITAL EQUIPMENT AND OTHER CAPITAL ITEMS**

Requests from City departments for capital purchases totaled over \$3.2 million. In order to balance the budget, substantial reductions were made to these requests. All City departments, with specific assistance offered by the Fleet Management 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 \$900,000 in savings to date related to downsizing the City vehicle and equipment fleet.

However, some equipment needs must be funded in order to sustain efficient and reliable City services. The proposed 2016-17 budget includes \$1,345,659 for equipment and other capital items. The major items include \$242,000 to replace one bucket truck for reliable electric service response, \$100,000 to make improvements at Bingham Tennis Center, \$270,890 for pooled vehicle replacements now that all vehicles have been assigned for maximum utilization in the departments, as well as six police vehicles totaling \$179,220. In addition, capital of \$161,300, \$65,173 and \$60,100 is included in the Water and Wastewater, Natural Gas and Golf funds, respectively. Details regarding capital equipment and other capital items along with corresponding amounts for each department can be found located within this document behind the tabs for the various funds.

### **CAPITAL CONSTRUCTION PROJECTS**

To bundle a finance offering more attractive to lending institutions in conjunction with the renovation of Washington Park and Holt-Moffitt Field, architectural design plans were completed and construction is underway for Phase II of the Lexington Utilities complex that has been in the pipeline for years. A total of \$3.3 million of electric building and \$2.3 million shared utility warehouse facility improvements was financed and leveraged as collateral along with the park improvements. Inadequate electric and warehouse facility needs and improved traffic flow for costly rolling stock at the Lexington Utilities complex are being addressed at a debt service cost of \$302,323 for the Electric Operations Center and \$229,897 for the Warehouse Center, which is shared by electric, natural gas and the water/wastewater utilities to store inventory that supports infrastructure with an aggregate value of over \$2 million.

### **ORGANIZATIONAL CHANGES AND EMPLOYEE BENEFITS**

The proposed budget does not include funding for the City's "pay for performance" employee merit plan, which has not been fully funded since 2007-2008. Without merits in the proposed budget and in an effort to regain some ground with market pressure, the City's pay plan does include a recommended 3% cost of living adjustment (COLA) for employees delayed until October 2016 at a cost of \$331,392, which will increase the grades for new hires by 2%. City employees have only received COLA pay adjustments five out of the last eleven years. The measured amounts budgeted in pay and benefits are

necessary to mitigate the declining revenues from the property tax revaluation and post-recession status of the local economy.

The cost of employee longevity pay remains funded at \$290,936. 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, the first phase of a comprehensive multi-year plan for health insurance benefits is enacted in the coming year requiring additional contributions from employees and retirees for their health insurance premiums.

Funding 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 continues being suspended in the coming budget year resulting in over \$250,000 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. Effective July 1, 2016, the Local Government Employees Retirement System Board of Trustees is including moderate increases in the base employer contribution to 7.35% of payroll for general City employees and 8.15% of payroll for law enforcement employees.

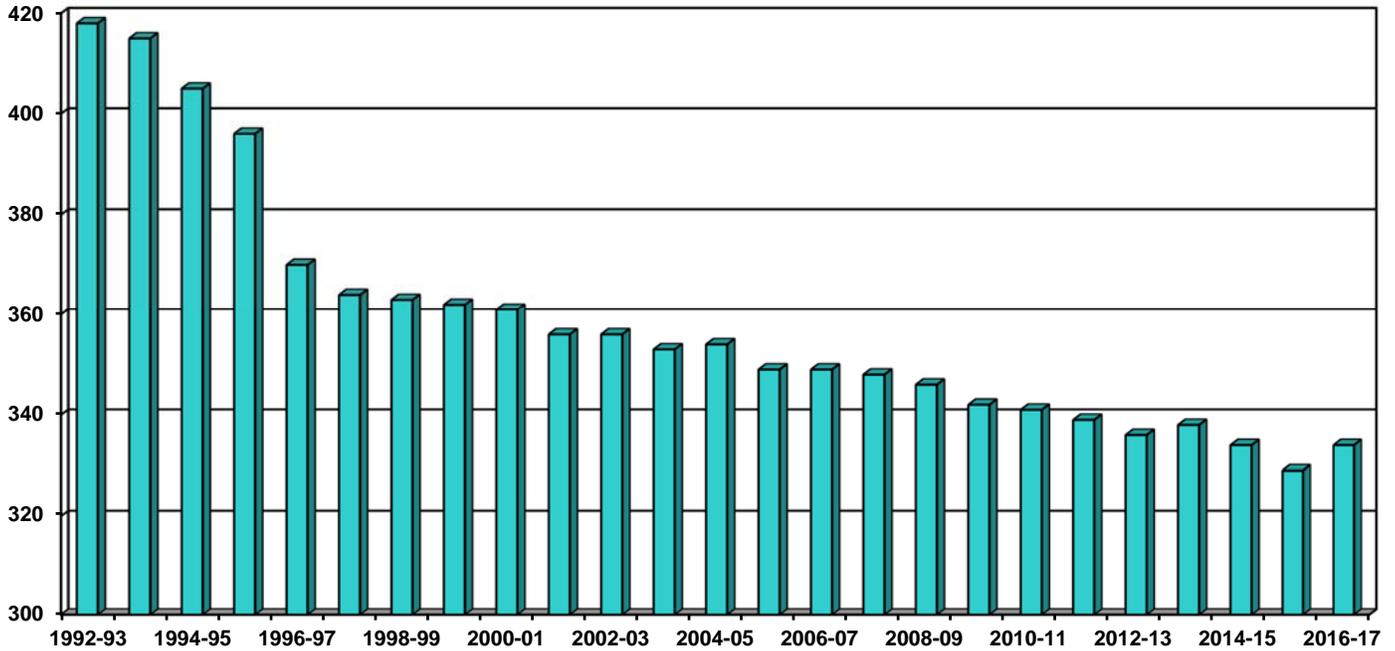
The proposed budget includes the deletion of three full-time positions via attrition, net of the addition of seven full-time positions throughout the following departments: Public Buildings, Police, Fire, Public Works, Golf and Fleet Services. The net effect of total full-time positions will be increased from 330 to 334. Additionally, funding for five full-time positions were delayed in the proposed budget to mitigate cost pressures.

External events and recent law enforcement incidents across the United States are affecting the recruitment and retention of quality law enforcement officers in agencies across North Carolina and the United States. Both local and state agencies are affected by these events and the influence on the recruitment and retention of quality law enforcement officers, as well as additional equipment expectations such as body cameras. Class sizes in Basic Law Enforcement Training at local and contiguous community colleges have experienced a dramatic reduction in the number of students. The competitive recruitment and hiring of police officers from other agencies has increased. The City of Lexington Police Department is experiencing these adverse impacts resulting in a 17% turnover rate; thus, funding measures are incorporated in this budget to address law enforcement compensation and invest in modernized equipment.

The City of Lexington conducted a starting pay salary study for Police Officer I's at 38 law enforcement agencies in North Carolina. Included in this study were benchmark and surrounding agencies. The average starting pay for these 38 agencies is \$35,086. The City of Lexington's current starting pay for a Police Officer I is \$31,666 and is recommended to bring current police officer pay that is under \$35,000 to a minimum of \$35,000 and maintain equitable pay spread. In accordance with the current City of Lexington Personnel Policy, the recommended reclassifications will result in 5% pay increases for current law enforcement officers in the respective positions. All current Police Officer I's and four Police Officer II's receive more than a 5% increase in order to bring minimum pay for current officers to \$35,000 and maintain equitable spreads in pay. These measures are recommended at the May 23, 2016 City Council meeting in an effort to expedite resolution to law enforcement turnover concerns.

As depicted by the graph below, the City has eliminated 90 full-time positions, an annual rate of reduction of 21% over the 24 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.



**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 \$1.275 million, while the transfer for the Natural Gas Fund currently stands at \$939,882. The Electric Fund transfer decreases in the proposed budget for 2016-17 to \$1.25 million as a good faith effort to invest in electric system reliability; while the Natural Gas Fund transfer is budgeted at \$972,049, a \$32,167 increase. The expansion of the natural gas system allows for the increased transfer. The budgeted transfer amounts for fiscal year 2016-17 have been thoroughly reviewed according to 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 includes a subsidy transfer of \$168,584, which covers the debt payment on the golf course renovation loan from 2003. This debt will be paid off in 2018. Also included is a \$150,000 additional infusion to support golf course maintenance and operational needs.

**CONTINGENCY**

The 2016-17 proposed budget contains one contingency appropriation in the Electric Fund in the amount of \$245,180 as a planned addition to build electric cash reserves that register below the municipally owned utility averages in the State of NC.

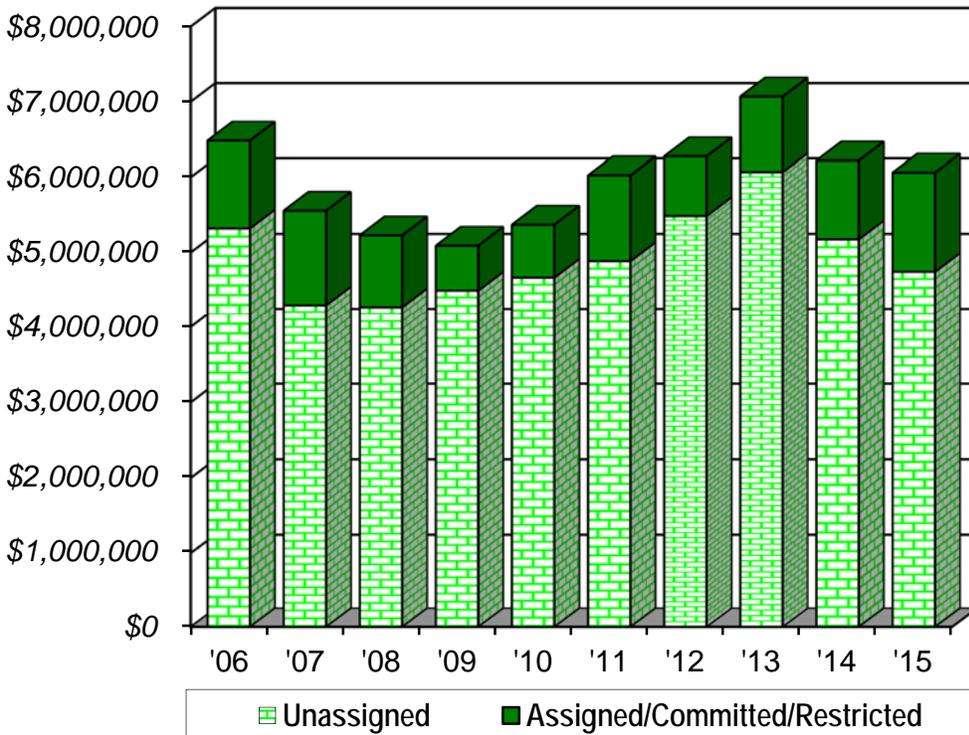
In the General Fund, the City will rely on a strong fund balance to cover any unexpected events, emergencies, or economic development opportunities. The following table estimates available fund balance in the General Fund for next fiscal year.

## FUND BALANCE PROJECTION

Unassigned Fund Balance 6/30/15 <b>(24%)</b>	\$ 4,744,018
Fund Balance Appropriated for FY 2015-16	1,292,822
Projected Reclassification from Fund Balance Restricted by Statute for FY 2015-16	809,920
Projected Revenues for FY 2015-16	21,249,132
Projected Expenditures for FY 2015-16	<u>(22,858,373)</u>
Projected Unassigned Fund Balance 6/30/16	<b><u>\$ 5,237,519</u></b>
Projected Fund Balance Available for Appropriation for FY 2016-17	\$ 5,237,519
Divided by General Fund Budget for FY 2016-17 (less administrative charges)	\$ 22,720,029
<b>City of Lexington Fund Balance Percentage Projection (target goal 25-32%)</b>	<b>23%</b>
Projected Fund Balance Available for Appropriation for FY 2016-17	\$ 5,237,519
Less Recommended Appropriation for FY 2016-17	<u>(772,298)</u>
<b>Remaining Fund Balance Available for Appropriation</b>	<b><u>\$ 4,465,221</u></b>

The City Council has consistently listed “maintain the City’s financial integrity” as one of its top goals. Fund balance is expected to decrease by approximately \$1 million in the current year. 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 strategic intermittent reliance and rebuilding of fund balance.

### HISTORY OF GENERAL FUND BALANCE AVAILABLE FOR APPROPRIATION



## **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 recommends changes to the following fees for the 2016-17 budget:

- Implement a security deposit to rent the Robbins Recreation Center for community activities
- Increase fees to recover costs for weekend and holiday burials at the cemeteries
- Implement expanded fees to recover electric costs for relocating service lines and poles
- Increase fees to recover wastewater costs for staff laboratory testing and monitoring mandated by the State of NC for industrial customers
- Increase fees at the municipal golf course and for the newly renovated Commons on the Green facility.

Please refer to page 160 (and the corresponding attachments) of this document for specific fee structures that will change and the corresponding amounts.

## **UTILITY RATE CHANGES**

Continued stagnant consumptions in the electric utility are anticipated in the proposed budget year due to local economic conditions and plant closings, energy conservation and post-recession impacts. 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 160 (and the corresponding attachments) of this document for specific proposed rate structures.

### **Electric Rates:**

Since July 1, 2001 due to plant closings, City electric industrial customer consumption has dropped by 82 million kWh or 74%. Despite the City's intense efforts to trim operation costs and delay system maintenance projects in the electric budget over the last decade or more, the City received over \$13 million in wholesale power cost increases from the North Carolina Municipal Power Agency No. 1 (NCMPA1) during that same time period. The fixed wholesale power costs represent 79% of the electric utility budget; leaving little financial flexibility for the City to absorb these cost increases in previous years. Initial projections for the 2015-2016 and 2016-2017 budget years indicated potential 5% rate hikes from NCMPA1, which could have adversely affected customer rates; however, this increase was avoided with the 2015 debt restructuring by NCMPA1.

Instead in July 2015 and proposed for July 2016, electric customers receive a 2.7% and 2% average retail rate decrease, respectively due to the successful 2015 NCMPA1 debt restructuring. Future wholesale rate cost impacts to electric customers are also mitigated by NCMPA1 continuing the transition to 'true up' the allocation of demand costs across the agency members over the course of several years between 2013 and 2021.

Proposed rate changes were prepared by ElectriCities' rate analysts and reflect the aggregate 2% electric rate reduction. Beginning July 2016, a typical residential customer who uses 1,000 kWh's per month will receive a monthly average of \$3.09 less 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.

Given water main break activity over the last year, the proposed budget includes an independent vulnerability assessment for the water and wastewater system and line replacement funding, intended to identify future capital improvement needs and possible funding requirements with a rate study component. Grant funding is being sought to assist in this endeavor. However beginning July 2016, proposed increases to the water and wastewater base rates are included at \$1.50 and \$.50 per month, respectively. The results of the consultant study and ensuing funding strategy for any system improvements is identified as a priority to be reviewed for further action by City Council in future budget cycles.

**RATE AND FEE IMPACTS ON RESIDENTS**

With the nationwide impact on local law enforcement creating \$550,000 compensation and equipment cost pressures and a recent property tax revaluation within the last year lowering real property values by approximately \$45 million, there is a proposed \$.05 increase in the property tax rate to \$.65 per \$100 of assessed valuation in the budget. For a home that is valued at \$100,000, the proposed \$.05 tax rate increase will affect a City resident by \$50 per year or \$4.17 per month.

The July 1, 2016 average 2% electric rate decrease will affect each electric utility customer differently 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 decrease an average of \$3.09 per month for a potential savings of \$37 per year.

The July 1, 2016 \$1.50 water and the \$.50 wastewater monthly base rate charge increases will affect each water and wastewater utility customer depending on the size of the meter, with commercial and industrial size meters bearing a higher prorated cost of service. For residential customers who receive both water and wastewater services, the bill will increase \$2 per month for a total of \$24 per year.

**BUDGET COMPARISON**

In summary, a comparison of the proposed fiscal year 2016-17 budget versus the current fiscal year 2015-16 budget is outlined in the table below.

**CITY OF LEXINGTON  
BUDGET SUMMARY AND COMPARISON**

<b>Fund</b>	<b>15-16 Budget</b>	<b>16-17 Budget</b>
General Fund	\$ 23,929,085	\$ 24,991,302
Controlled Substance	89,152	84,680
Special Tax District	90,000	100,000
Electric Fund	51,967,136	50,634,511
Water & Wastewater Fund	8,863,961	9,696,926
Natural Gas Fund	13,237,331	10,698,509
Golf Fund	1,008,732	1,146,431
<b>Total City Budget</b>	<b>\$ 99,185,397</b>	<b>\$ 97,352,359</b>

The chief differences, leading to the \$1.8 million decrease from the \$99 million current budget to the \$97 million proposed budget, are generally due to electric wholesale purchased power cost savings with

the 2015 debt restructuring by NC Municipal Power Agency #1 and anticipated savings in the wholesale market cost of natural gas; countered by additional General Fund revenues being directed towards combating nationwide pressures on law enforcement through compensation and equipment investments, City Council's goals and initiatives including strategic investments in the "Re-creation of Recreation" master plan, and economic development initiatives. To ignite progress towards the long range enhancements of recreational facilities in Lexington, multi-year funding is included to purchase the building to be transformed into an indoor recreation center, debt service for the newly renovated Lexington Aquatic Park (former donated Hillside Pool) and for the renovation of Holt-Moffitt Field and Washington Park including a splash pad, and professional services to facilitate preliminary design and citizen involvement in the remaining phases of the recreation master plan. Finally, General Fund revenues are also directed to fund City Council's goal of green initiatives to complete the final year of a four year phase-in of the residential recycling rollout program.

## **SUMMARY AND CONCLUSION**

The City's Annual Budget is the ultimate partnership between City Council, staff, citizens, customers and partners in the Lexington community. In the aftermath of tough economic times, the proposed budget reflects a balanced approach of limiting impacts to its citizens and customers, securing electric rate relief for utility customers; while simultaneously providing funding for a revitalized economic direction, the "Re-creation of Recreation" master plan, quality of life and green initiatives. The budgeted funding is weathering the storm of the local economy and revenue losses, while fulfilling the responsibility to maintain and protect important infrastructure and invest in a new Lexington economy and quality of life.

In conclusion, City Council's goals and general approach to governing remains highlighted in the budget for fiscal year 2016-17; those directives being to expand citizen involvement, employ and retain 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 and service efficiencies sought
- Partnerships are nourished
- New technology is acquired
- Community's security is enhanced through public safety
- Retains and supports professional employees in delivering efficient and effective services
- Public infrastructure is built and maintained
- Recreation for citizens is enhanced
- Public health is guarded by recycling, waste collection and water resources
- Reliability of utility services and enhancements to emergency responsiveness is funded
- Key City services necessary to support local economy are maintained and enhanced
- City financial integrity is maintained to meet service and debt obligations
- Affordable housing and addressing community appearance is supported
- Improved quality of life is sought for all citizens

The budget is hereby formally presented to City Council at the May 23, 2016 City Council meeting and City Council is requested to set a public hearing date for June 13, 2016 at 7:00 pm in City Hall. After holding the public hearing and if there are no other changes, I recommend the fiscal year 2016-2017 City Budget for adoption by City Council.

Respectfully submitted,

A handwritten signature in black ink that reads "J. Alan Carson". The signature is written in a cursive style with a large, sweeping initial "J" and "C".

J. Alan Carson  
City Manager