

CITY OF GASTONIA

EXECUTIVE SUMMARY

The following section consists of the City Manager's budget message, which highlights the major policy changes adopted for the new fiscal year, the Budget Schedule for the Fiscal Year 2007 budget, and an Explanation of the Budget Presentation, which details the layout of the balance of this document.

Presented to the City Council
April 28, 2006

Adopted in Final Form by the City Council
June 20, 2006



City of Gastonia

A Commitment to Excellence
July 1, 2006

CITY MANAGER'S BUDGET MESSAGE

Dear Mayor and City Council:

Enclosed is Gastonia's fiscal year 2006-2007 Annual Budget. I want to thank all the City employees whose hard work and dedication to their jobs contributed to the preparation of this budget. The budget is our financial plan that will guide the City through the coming fiscal year. We will manage the budget to take advantage of opportunities and meet challenges as they occur during the year. Some of the language in this year's budget message is new, but other language remains the same, because many of our opportunities and challenges require steady commitments through multiple years.

Challenges

Economic Condition:

Recent operating budgets have reflected the difficult financial conditions that affected our City, County, and State. These conditions have included the great economic impact on our community associated with the passage of international trade agreements, which resulted in the loss of manufacturing jobs, particularly textiles, and the numerous businesses that supported textiles. The loss of textile and other manufacturing has had a significant effect on the General Fund, the Electric Fund and particularly on the Water and Sewer Fund.

Beginning in 2004 and continuing through the first quarter of 2006, Gastonia began to experience some return of positive economic growth. Several retail commercial developments have been constructed. Small industrial relocations and expansions have occurred as well. New residential development is planned and under construction in every direction on

the edges of the City. The challenge for Gastonia is to encourage developments of high quality. Developments with high values are more fiscally sustainable and contribute more to the expansion of the tax base. Consistent with our land development plans, Gastonia encourages commercial, office, industrial and residential development arranged in a manner that is interconnected and sensitive to our environment. In particular, infill developments are the most desirable form of economic growth because the infrastructure is already in place, thereby reducing the cost to serve the new development. High value growth is important to the General Fund and also to our utility funds that need the growth of customers to broaden their base. ***It is our objective to grow our tax and utility bases and not our rates.***

Revenues:

Property Tax:

The 2006-2007 fiscal year budget for the City of Gastonia does not include any increase in the property tax rate. The estimate for property tax revenue received from the County Tax Office is changing each week. The tax revenue growth projection for next fiscal year equates to an increase of 2.70% compared to the 2005-2006 budget. This is the highest estimate for the past few years.

Sales Tax:

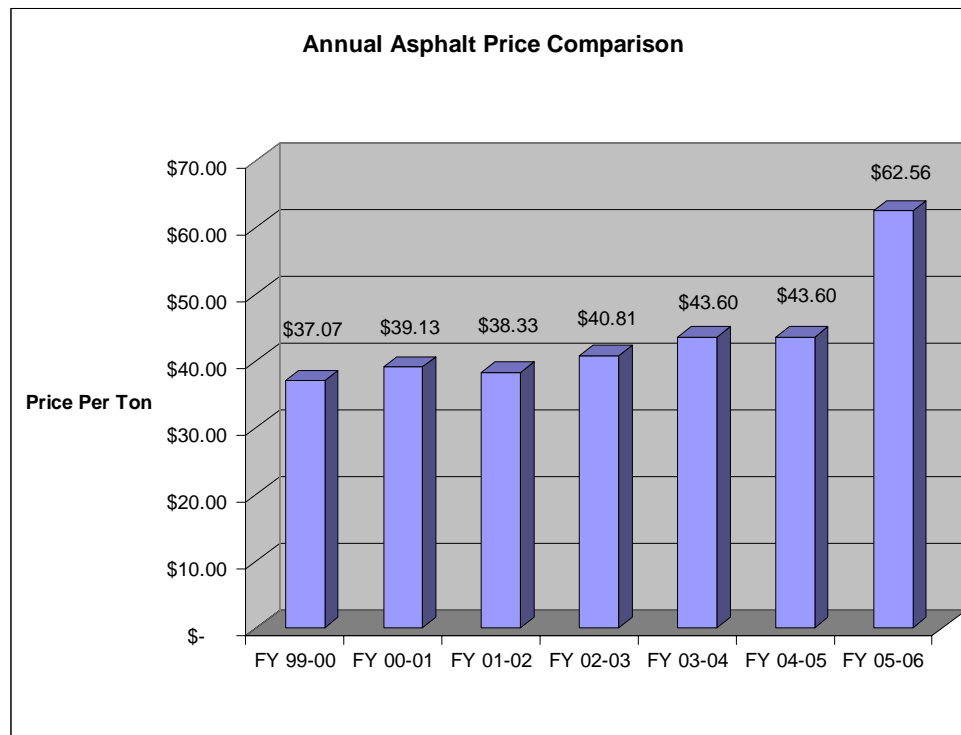
Three years ago, the Gaston County Commissioners announced their intent to change the Sales Tax distribution formula from the Per Capita method to the Ad Valorem method. This change, if immediately implemented, would have resulted in an annual loss to the City of Gastonia of approximately \$2.5 million in our General Fund. Through determined efforts of municipal officials and a willingness of County officials to compromise, an Inter-Local Agreement was signed two years ago that caps the municipal share of Sales Tax revenues at the 2004-2005 amount. All future growth in the Sales Tax revenues, historically averaging 4.5%, would be assigned to the County, until the economic growth equals 92% of the Ad Valorem method. The Inter-Local Agreement specifies that the County must divide their newly captured money – 50% to the public schools and 50% for water and sewer improvements. County funding of the waterline through the Gastonia Technology Park and to Costner Elementary School meets the standard set forth in the agreement. The revenue loss for budget year 2006-2007 is estimated to be \$490,000. Since Sales Tax revenues are used to pay for basic operating costs in the General Fund, the annual loss of Sales Tax revenue growth creates a problem for the General Fund operating budget for years to come.

Infrastructure:

The City of Gastonia is responsible for approximately 419 miles of roads, both local and State, with sidewalks and traffic control systems; 512 miles of water lines; 485 miles of sewer lines, 250 miles of storm water lines, and 438 miles of electrical distribution lines. Our municipal facilities are spread from Mountain Island Lake to the South Carolina state line. One of the most important responsibilities of our City and most cities is to provide and maintain the critical public

infrastructures that we all take for granted. The major commitment, made two years ago, by the City allocated \$15,000,000 for infrastructure maintenance to the City's Water Plant, Waste Water Treatment Plants and utility lines. Last year the City allocated funds through the Supplemental Budget for street resurfacing and parks and recreation repairs. Additional challenges related to maintaining other aspects of our vast infrastructure will be addressed through this budget and future budgets. Maintenance of our infrastructure, such as roads, water, sewer, electric and other City facilities, while not glamorous, is critically important and commands significant resources to maintain. In order to capture new economic development opportunities we must also find ways to expand our utilities infrastructure, particularly to the Southeast and to the Northwest.

Fuel costs and other petroleum-based products are also creating pressure on our current year's budget and impacts next year's budget as well. We have projected a 20% increase in fuel above the expected 2005-2006 budget as ultimately amended. In just the two years, the cost of fuel has increased by 63%. Petroleum-based products, such as asphalt, also have experienced sharp increases in price, as depicted by the following chart.



Center City:

Finally, Gastonia's Center City area has been identified as being critical to our economic development and to our image. Significant areas in central, northern, and western portions of the City have still not experienced the kind of economic growth that is otherwise occurring throughout the region. The City will be challenged to work with the private sector to redevelop these areas, thereby expanding Gastonia's economic and revenue base.

The City must continue to focus on the Center City, and much more work remains in front of us. Construction has begun on street improvements to the US 321 Corridor between Downtown and Interstate-85. The City has approved three levels of development incentives for the Center City, including incentives to promote housing. The three Gastonia Rotary Clubs finished the impressive Rotary Pavilion, which is the new venue for Downtown activities. The City received approval this year from the US Department of Housing and Urban Development to provide "gap financing" loans to assist with new commercial redevelopment such as the Standard Hardware Project. The York-Chester neighborhood has completed the process for National Register recognition. Brownfield approval for the North Gate Shopping Center site has been completed. The new parking lot will be finished this year in conjunction with the Standard Hardware project. The sale of the Main Avenue properties should take place this year. Loray Mill developers believe that they will be able to begin renovating early next year, stimulating the Loray neighborhood. Community Development will be targeting the Highland-East neighborhood for new housing. The Oakland neighborhood has new design standards for infill and rehabilitated housing. Other projects that hold promise for Gastonia's Center City should develop in the coming months and years.

Opportunities

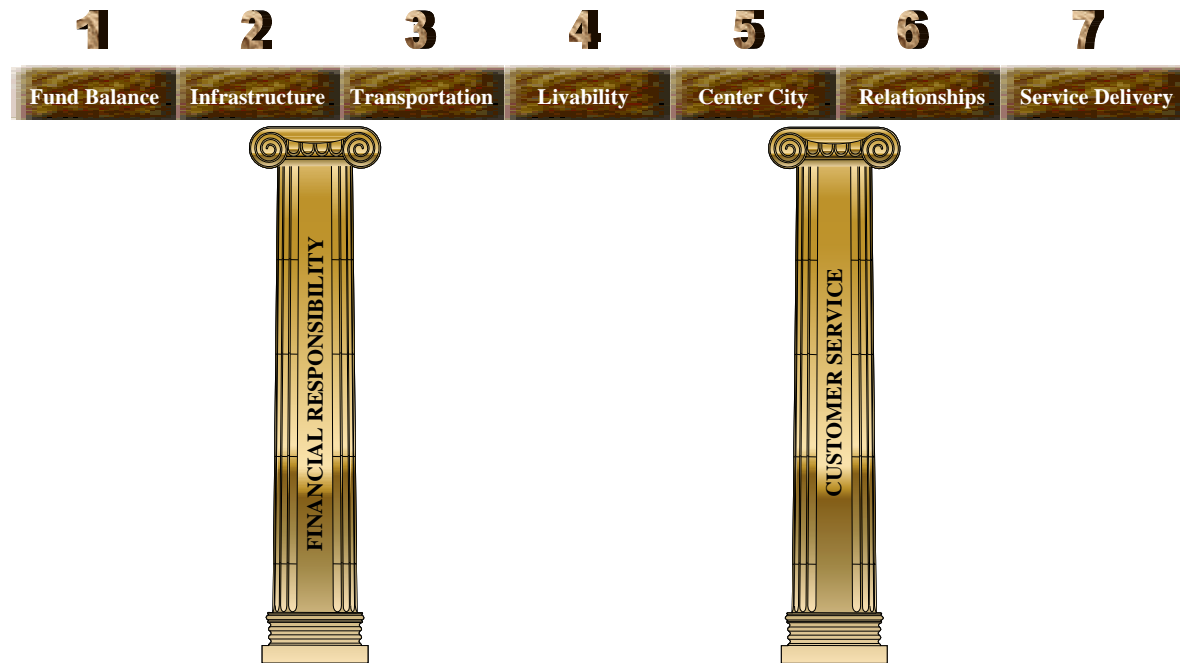
Despite the challenges facing the City, the long-range future for Gastonia remains bright. We are located in one of the fastest growing and most affluent metropolitan areas in the United States. The region is home to the second largest financial center in the country. Gastonia is located only twenty-five minutes west of the center of the region. Our location is excellent! Interstate 85, the transportation link between Atlanta and Charlotte, bisects our City with eight interchanges. US Highway 321 links us to Hickory and Interstate 40, while the proposed Garden Parkway would further connect Gastonia to the Charlotte International Airport and Interstate 485.

We will need to make wise investments (expenditures) that capitalize on our location within the metropolitan region. Also, we will need to capitalize on our current strengths - an abundant water source at Mountain Island Lake, natural features such as Crowders Mountain State Park, the Schiele Museum, the quality of our neighborhoods, schools such as Highland School of Technology, the York-Chester Middle School International program, the new Science Academy at Grier Middle School, park facilities from Lineberger Park to Martha Rivers Park and the on-going connections of our greenway system. The City Council has given guidance to the Tourism Development Board for Schiele Museum Improvements and for a new branding/marketing/communications initiative. Funding for this initiative is provided through ElectriCities and

occupancy tax revenues. To further enhance our ability to attract quality new investment, we must create a positive private investment climate. Streamlining our regulatory process while delivering excellent citizen services will be our challenge through the coming year and for years to come.

BUDGET INITIATIVES

The budget addresses, within the scope of available revenues, the goals and many of the action steps identified by the City Council and Mayor this year, and are outlined in writing in the Mayor/Council section of this budget (pages E-2 to E-5). As reflected by the drawing below, **financial responsibility and excellent customer service are the pillars that support all our City goals.**



The following are significant initiatives that drove the development of the budget this year.

Maintaining the Fund Balance

During the past three years, the City has increased its Available Fund Balance in the General Fund from 4% to 15.7% (estimated October 2005). Through a disciplined approach to expenditures, Gastonia is now sufficiently over the 8% minimum Available Fund Balance recommended by the Local Government Commission. We have reached our goal as defined in City's Reserve Policy that the Available Fund Balance should be between 12% and 15%.

The Fiscal Year 2006-2007 Budget neither reserves new revenues to further build the Available Fund Balance nor allocates the previous Available Fund Balance to cover expenditures for next year. The 2006-2007 Budget maintains our current Available Fund Balance in the General Fund. We anticipate that the Available Fund Balance may increase again when all revenues and expenditures are accounted for, after the close of the 2005-2006 Budget Year. However, a large amount of General Fund revenues are not received by the last day of the fiscal year, June 30, 2006. Accounting practices will allocate the last three months of sales tax and reimbursements received during the summer back to the 2005-2006 Budget Year. The Finance Department and our auditors will not know the exact amount we have added to the Available Fund Balance until September 2006. The staff has developed estimates for next year, which change as rapidly as the fluctuation of gasoline prices. For the coming year, the staff will tentatively allocate the estimated amount of Available Fund Balance above the current level for capital improvements. Therefore, the "one-time" fund balance revenues are not used to fund ongoing multi-year operating expenses.

This year's budget plan continues the disciplined approach to maintaining the Fund Balance through capturing expenditure reductions through more efficient operating procedures.

Electric Fund: Investing for Economic Development

No retail electric rate increase is recommended at this time. The FY 2006-2007 Proposed Budget absorbs all of the wholesale rate increase. The average ElectricCities wholesale rate increase for Agency One cities is scheduled to be only .8% effective July 1, 2006. However, if Gastonia's load growth does not increase to the average of the other jurisdictions in Agency One, our effective wholesale rate could increase for next year. Therefore, it becomes even more important to expand economic development into the areas served by City electric. Funds will be available for redevelopment as well as for new growth corridors. Tier 1 and Tier 2 Discounts will be phased out by ElectricCities beginning July 1, 2006. The 2006-2007 Budget phases out the discount program over ten years and provides \$450,000 annually to the Electric Department for economic development/capital improvements. Funding for all the possible electric capital projects will

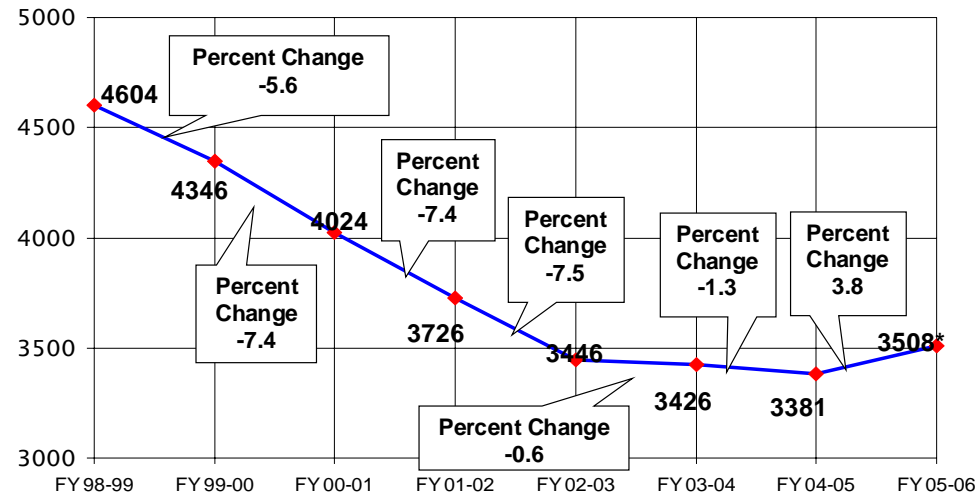
challenge the City in the next few years. The FY 2006-2007 Budget also continues our policy to reduce transfers from Electric Fund to the General Fund by reducing transfers by another \$100,000. After many years of sustained effort, Gastonia is now at the level established by the Local Government Commission as acceptable - 3 percent of Gross Electric Fixed Assets. The City should continue to reduce the subsidy to the General Fund as it may practically be done. The 2006-2007 Budget provides more funding for maintenance and capital projects. Expenditures in the Electric Fund are organized into three priorities: **safety & maintenance, peak shaving & generation, and load growth initiatives.**

Water and Sewer Fund: Operations and Capital Improvements

After five years of steep decline and two years of modest decline, Water and Sewer sales are projected to grow this fiscal year by more than 3%. We are estimating that water and sewer sales will grow again next year. The following chart depicts the improved situation in the Water and Sewer Fund.

City of Gastonia Public Works & Utilities

Annual Million Gallons Billed
FY 98-99 thru FY 05-06



*Million Gallons Billed Estimated April thru June 2006

—◆— Million Gallons Billed

A modest 1% water and sewer rate increase is recommended to partially compensate for the loss of revenues from Kings Mountain of approximately \$675,000 next year. A 1% rate increase will provide about \$275,000 annually to the Water and Sewer Fund. This represents the lowest rate increase in many years. Based upon our latest projection of water and sewer sales for next year, a 2.0% increase in overall system growth is necessary to meet the traditional operation and capital funding level for the system. Federal and State mandates continue to increase operational expenditures as well as system maintenance and chemical costs. The EMA Performance Study, completed last year, will guide operational changes designed to control operating costs and address infrastructure needs.

Work continues on the \$15 million capital projects program approved two years ago to address system maintenance needs in both water and sewer. New capital needs both for maintenance and line extensions into growth areas, will challenge the system. Fortunately, beginning with Fiscal Year 2006-2007, debt service cost will be reduced each year, providing opportunity to address these needs through new debt issuance.

We have and will continue to partner financially with the private sector, other municipalities and the County to extend lines into our important growth areas – West, Northwest and Southeast. We will also seek to increase water and sewer usage through infill development because the infrastructure is already in place. Our priority for the Water and Sewer Fund will continue to be: ***increasing our sales, infrastructure maintenance, system performance, and system expansion.***

Transportation Infrastructure and Improvements

From a low of \$148,972 four years ago, the City increased funds available for maintenance last year to \$467,000, utilizing funding from Community Development in addition to General Fund revenues. The current 2005-2006 budget allocated \$167,000 for street and sidewalk repairs as well as \$280,000 in the base budget and another \$160,000 of street resurfacing funds through the Supplemental Budget. Therefore, a total of \$607,000 is available for street and sidewalk maintenance for Fiscal Year 2005-2006. The Budget for FY 2006-2007 increases the total to \$721,000 (\$471,000 operating & \$250,000 capital). The Municipal Airport runway has been resurfaced. The 2006-2007 Budget provides matching funds, to resurface portions of the ramp areas.

Although funding for any kind of road improvements has been very limited, the City has placed priority on traffic calming, matching grant opportunities, the U.S. 321 North corridor improvements and small-scale sidewalk and streetscape

improvements. In order to have even a modest amount of new street, sidewalk and center city streetscape projects for coming years, new debt through a two-thirds issue should be considered this year. Working with the State Department of Transportation, we will continue to press for the next section of the Franklin Boulevard resurfacing, completion of transportation improvement projects such as the US 321/185 Interchange Project, NC "Moving Ahead" projects, NC Enhancement Grant funding and the Garden Parkway.

Funding For Equipment

Equipment (Rolling Stock) and Computer/Communications equipment are funded through an annual equipment loan. The loan for the equipment is spread over a fifty-nine month period, thereby leveling the impact of equipment needs from year to year. In the 2006-2007 Budget we are funding equipment replacement through the fifty-nine month loan method for a total of \$2,002,266 for Equipment (Rolling Stock), and \$709,750 for Computer/Communication equipment. We are proposing to replace 30 Police vehicles and other diverse equipment including an electric bucket truck, an electric underground service truck and fairway mowers for the golf course. More than \$4 million of equipment was requested by City departments for replacement or additional equipment. For the 2006-2007 budget year, all requests by departments for replacement equipment that were approved by the Equipment Manager/Garage are included in this proposed budget. A complete list of equipment to be purchased was included with the 2006-2007 Proposed Budget.

Employee Compensation

Based on the current revenue forecast, the FY 2006-2007 Budget includes funding for a 4% increase for all City employees, as well as supplemental funding for the below market positions identified in the Centralina Council of Governments Compensation Study. The total increase for any below market employee would be capped at 7.2% of current pay. The distribution for the 2006-2007 year will be across-the-board for most employees effective July 2006. Police and Fire are considering step plans that will distribute the funds differently, but still within the 4% funding allotment. Performance reviews for all employees are underway and new evaluation forms have been prepared and are currently under review. Next year (2007-2008), subject to available funding, a portion of the compensation is planned to be in the form of merit for employees not in the step plans. The FY 2006-2007 Budget also increases the annual Christmas Bonus to 3% with a maximum of \$300 to each eligible employee. This returns the bonus amount to the level provided ten years ago. Negotiations with insurance providers are still on-going. The 2006-2007 Budget includes an estimated 5% increase for health insurance. As proposed, the budget absorbs 100% of the increased cost, approximately \$480,000, to the base health insurance plan for individual employees, dependents, and retirees. Beginning with the new fiscal year, the City will be self-funded for health insurance. The change should reduce the rising cost of health insurance in coming years. The

self-funded revenues and expenditures will be separated from all other City funds. The status of these funds will be reported monthly and reviewed by the Insurance committee of City Council at least quarterly. An additional 0.5% is added to the 401(A) program for general employees, thereby having all employees at the 5% level, the same as police and fire employees. The 2006-2007 Budget also provides funding for the Employee Education Reimbursement Program. Following the City Council's review of the Budget, it was decided that additional funding for employee compensation would be considered in September 2006.

Creating and Maintaining a Fiscally Sustainable Organization for the Future

In preparing this budget and during City Council work sessions this year, the staff has focused beyond this year's budget developing and refining pro formas that carry forward revenue and expenditure trends through the next five years. The pro formas for the Water and Sewer Fund and the Electric Fund require growth in sales to avoid utility rate increases. For the General Fund, the loss of Sales Tax revenue growth, resulting from the action of Gaston County, has created an on-going structural deficit that can be addressed in the long term through economic base growth. On the revenue side, the General Fund depends upon tax base growth, which is tied so closely to the economic condition of our community. Property Tax revenue growth for the new fiscal year is improved from previous years and is projected to grow by about 2.70%. Budget year 2007-2008 will have the new property values resulting from the 2008 Gaston County Property Reevaluation. Regarding future expenditures, over 66% of the General Fund consists of salary and fringe benefits. So meaningful changes to General Fund expenditures must include human resource costs.

During the past few years, each City department has been asked to perform its responsibility with smaller permanent staffing. This effort has been the singularly most important step taken by the City to control its financial position. The 2005-2006 Budget and the Budget for 2006-2007 actually stabilizes the size of our workforce and increases investment to both infrastructure and to our employees. Even though the City's financial situation has improved, we must be always vigilant for ways to reduce operating costs. Some operating costs will increase no matter what we do, such as with the recent sharp rise in fuel costs. In some cases services can be reduced, as the City did when we moved from twice a week rear-yard garbage service to once-a-week rollout service. There may be some services that simply cannot or should not be reduced at all. In those cases, we will still carefully examine their operating procedures to produce savings. The nature of these changes will be developed cooperatively with each City department and the budget office of the Financial Services Department. The City must continue to seek ways to further reduce expenditures through a variety of means. Expenditure reductions can be accomplished by using the following tools: ***process simplification, technology and automation, program reduction, program elimination, consolidation, privatization, and innovation.***

Our organization and regulations should be streamlined to allow decision-making easier and more efficient. The structure of our organization should be as flat as we can make it. Fewer levels of organization will make us more efficient. We will continue our benchmarking efforts with the FY 2006-2007 Budget through the North Carolina School of Government's Performance Management Program. Gastonia works with Hickory, Winston Salem, Wilson, Salisbury, Cary, Charlotte, High Point, Asheville, Raleigh, Wilmington, and others, in benchmarking and examining best practices for delivering services. We will also utilize offers from local private sector companies, management firms, International City Managers Association (ICMA) resources, as well as information from professional organizations related to each of the services studied.

Projections of revenue growth for the near future have increased, allowing more room for expenditures. New and expanded expenditures are carefully evaluated and must be viewed as an investment. Questions should be asked. If we make this expenditure, what kind of investment return will the City receive? It may be tangible, such as a load management generator that could pay for itself in a year and a half, or intangible, such as a new greenway connection. We must view each new expenditure as one that may cause us to reduce an expenditure elsewhere within the City. A request to spend funds must always be viewed within the larger context of our budget. What is the choice we are making? Are we sure that this is the best utilization of our very scarce resources? We must also ask hard questions about the effectiveness of existing expenditures, be willing to modify our service levels and look for innovative ways to deliver services in the most efficient and effective manner.

Regularly, the City reviews user fees so that the actual costs can be tied to services delivered. Fees are adjusted to reflect actual costs and to be consistent with City objectives and with the market. Normally, fees increase over time but there are occasions that the City has reduced fees based upon lower actual service costs or to encourage more use of a service. During the Budget Work Sessions, the staff will identify areas for consideration.

A significant portion of the City's growth is occurring at outer edges of Gastonia, requiring the extension of utility services, roads and other municipal services from sanitation and meter reading to police and fire. Evidence across North Carolina is that annexation of land around a city is good in the long run. The healthiest cities are those that annex the strategic areas surrounding their city. We must be careful to manage the growth and the delivery of services so that the revenues balance expenditures. Typically, municipal services are stretched for a short period of time before comfortable service levels are achieved.

In closing, there were many operating and capital projects that were worthy, but limited funding has resulted in their consideration for subsequent years. Issuance of \$3,100,000 of Two-Thirds General Obligation Bonds in the coming year provides one option to provide additional resources for capital needs. For the new fiscal year, our efforts will focus on implementing actions that support the 2007 City Council/Mayor Goals to build a City with economic development and livability. There will never be a day or year when we have finished our efforts. We will continue to move toward a system of constant quality improvement that always examines what we are doing and looks for ways to do it better.

Respectfully submitted,

Edward C. Munn

Edward C. Munn
City Manager

BUDGET SCHEDULE - FISCAL YEAR 2006-2007

January 5, 2006	Council worksession to establish goals and objectives.
January 13, 2006	Preliminary revenue and expenditure budget worksheets and information sent to the Departments.
February 3, 2006	Preliminary revenue projections due.
February 24, 2006	Expenditure worksheets, new program initiatives and capital project worksheets due. Comments can be entered once expenditure worksheets have been turned in to the Budget Office. Initial insurance and equipment requests due to the Budget Office.
March 3, 2006	All comments should be entered. The Departments can make no further changes unless approved by the Budget Office.
March 6-10, 2006	Mission Statements/Goals & Objectives/Accomplishments due. Analysis and reports by the Budget Office.
March 13-March 21, 2006	Review of departmental requests by City Manager, Assistant City Managers, Department Heads and Budget Department staff. Reviews will be scheduled daily. Department Heads should try to leave their schedules open for this week.
March 20, 2006	Council worksession: Compensation.
April 11, 2006	Council worksession: Budget Outlook
April 19, 2006	Budget should be finalized and balanced based on recommendations of the City Manager.
April 27, 2006	Proposed budget should be printed and notice of public hearing completed.
April 28, 2006	Budget presented to City Council and press.
May 2, 2006	Public Hearing on the Budget at the Council Meeting.
May 15 & May 22, 2006	City Council budget work sessions to be held Council Chambers, City Hall.
June 14, 2006	Any final adjustments to the Proposed Budget should be submitted for inclusion in the Agenda.
June 20, 2006	Adoption of the Fiscal Year 2006-2007 budget.

Explanation of the Budget Presentation

FUND LAYOUT

This budget is designed to present revenues and expenditures by Fund and expenditure detail by Department. The format of this budget is basically the same as last year. It begins with a section laid out by Fund which includes revenue and expenditure summaries. Each Fund type has a locator tab with the Fund type listed on the tab.

There are six Fund types in the Fiscal Year 2007 budget. They are as listed on the right side of the page. An explanation of each Fund type is included in the glossary located in the Appendices section of this budget.

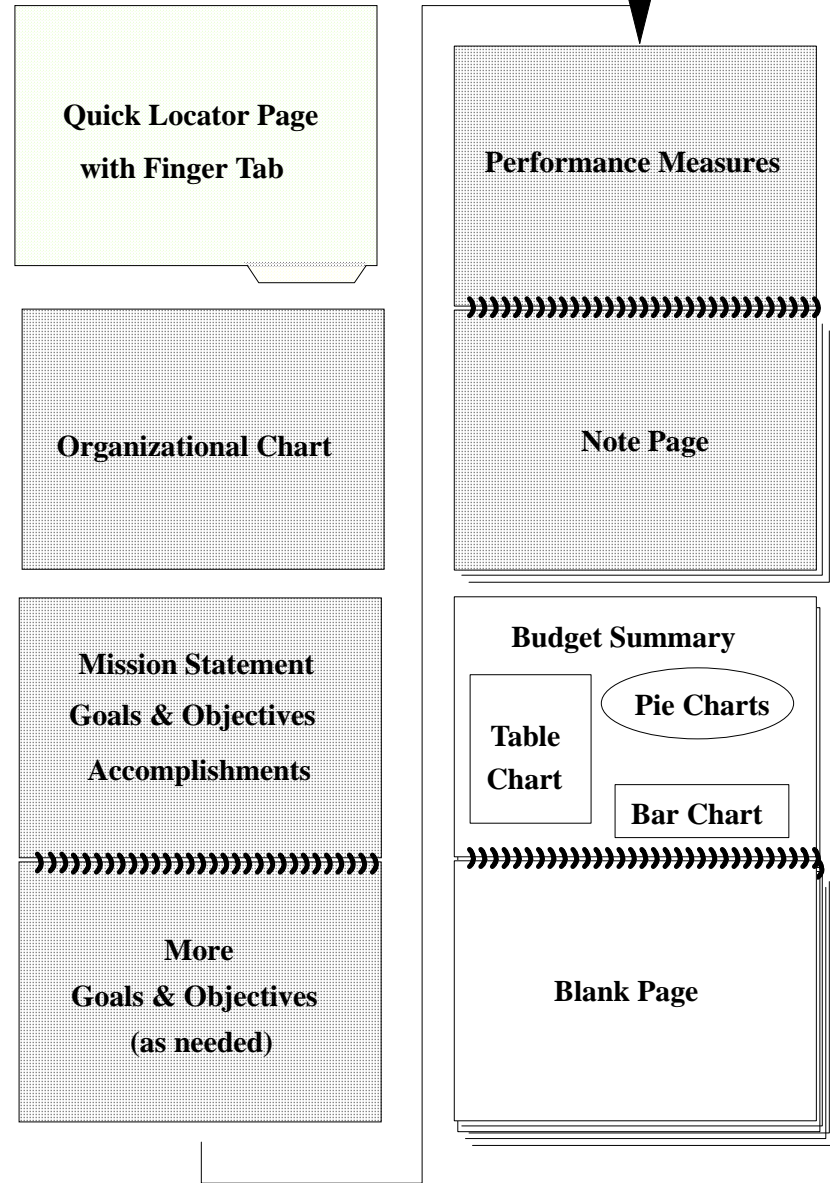
The layout of the expenditure detail information is graphically explained on the following pages.



EXPENDITURE DETAIL LAYOUT

The expenditure detail section includes the information as shown in the page layout on the right side of this page. The detail begins with the Mayor/Council budget and proceeds to the City Manager and those departments which are directly under his perview. Thereafter, it is organized by Assistant City Manager with the departments following alphabetically.

Following the organizational chart are the department's Mission Statement, Fiscal Year 2007 Objectives and Fiscal Year 2006 Accomplishments. The next page presents an overview of the department's budget in the form of a summary. (Please see the next page in the introduction for a more detailed explanation of the overview/summary section.)



The budget summary page is in chart form. It allows the reader to get a "quick picture" of the department's proposal. The chart on the left side of the page is a table which summarizes expenditures by division (or function) within the categories as generally used in the City's monthly financial reports. These categories are as follows:

- Salaries
- Fringe Benefits
- Equipment
- Other Capital Outlay
- Purchases for Resale
- Debt Service
- Other Operating Expenditures

The divisions are listed top to bottom in the same sequence as the detail following the chart. The department codes included in each division (or function) subtotal are listed in the bar beside the division (or function) name. These codes (XX-YYY) represent the fund (XX) and department (YYY) as reported in the upper left corner of the detail sheets which follow the summary page. In the case of multi-division/function departments, totals are provided at the bottom of the chart. Total expenditures are compared to total revenues and utility reimbursements. Utility reimbursements are overhead costs charged to the Enterprise Funds for services provided.

The right side of the chart page is basically a visual illustration of the text and numbers which appeared in the table discussed above. Just below the department name is the department's total expenditures as compared to the total operating budget and reported as a percentage figure. Next is a pie chart showing the percentage of the budget allocated to each division (or function). A second pie chart portrays the allocations by the expenditure categories. The horizontal bar chart at the bottom right compares expenditures, revenues and utilities reimbursements/service charges. This is a graphic illustration of the information on the bottom line of the table.

