

INTRODUCTORY SECTION





FINANCE DEPARTMENT
INTEGRITY FIRST

October 24, 2016

To the Honorable Mayor, members of the City Council and the Citizens of the City of Lexington, North Carolina:

I am pleased to present the Comprehensive Annual Financial Report (CAFR) of the City of Lexington, North Carolina for the fiscal year ended June 30, 2016. I am extremely proud that this report has been prepared in its entirety by the City's Finance Department.

State law requires that all local governments publish as soon as possible after the close of each fiscal year a complete set of financial statements presented in accordance with accounting principles generally accepted in the United States of America and audited in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. The audit must be performed by a certified public accountant or by an accountant certified by the North Carolina Local Government Commission as qualified to audit local government accounts. This report is published to fulfill that requirement for the fiscal year ended June 30, 2016.

Management of the City of Lexington, North Carolina, assumes full responsibility for the completeness and reliability of the information contained in this report, based upon a comprehensive framework of internal control that it has established for this purpose. Because the cost of internal control should not exceed anticipated benefits, the objective is to provide reasonable, rather than absolute, assurance that the financial statements are free of any material misstatements.

Martin Starnes & Associates, CPAs, P.A. has issued an unmodified ("clean") opinion on the City of Lexington's financial statements for the fiscal year ended June 30, 2016. The independent auditor's report is presented as the first component of the financial section of this report.

Management's discussion and analysis (MD&A) immediately follows the independent auditor's report and provides a narrative introduction, overview, and analysis of the basic financial statements. MD&A complements this letter of transmittal and should be read in conjunction with it. The City of Lexington's MD&A can be found immediately following the report of the independent auditors.

The financial statements of the City of Lexington were audited in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, which require the independent auditor to report not only on the fair presentation of the financial statements, but also on the audited government's internal control over financial reporting and on compliance and other matters. Also, the independent audit of the financial statements of the City of Lexington was part of a broader, federally and state mandated "Single Audit" designed to meet the special needs of federal and state grantor agencies. The standards governing Single Audit engagements require the independent auditor to report not only on the fair presentation of the financial statements, but also on the audited government's internal controls and compliance with legal requirements, with special emphasis on internal controls and legal requirements involving the administration of federal and state awards. These auditors' reports are included in the compliance section of this report.

Profile of the Government

The City of Lexington, North Carolina, was settled in the industrial region of North Carolina known as the "Piedmont Triad Area" in 1775. Lexington incorporated in 1828 under North Carolina General Statutes and became the county seat of Davidson County in 1847. Lexington's land area is 18 square miles with a population of 18,690. The City of Lexington is empowered to levy a property tax on both real and personal properties located within its boundaries.

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

The "Statement of Purpose of the City of Lexington City Council" is a document in which the Council identifies its mission and its values. Each February, strategic goals are prioritized and set by City Council at the annual retreat. The Council aims to maintain as high a service level to its citizens as possible but in a manner consistent with maintaining the City's sound financial condition. The strategic goals of the Council are accomplished by the City's management team through long-term financial and operational planning, the prudent use of debt, and incorporating appointed boards and committees to add another level of review in managing the City's resources to match citizen expectations.

The City provides a full range of services including police and fire protection, sanitation recycling and waste collection services, the construction and maintenance of streets and infrastructure, parks and recreational activities, cemetery services and cultural events. In addition, the City of Lexington owns and operates four utility services: a water treatment and distribution system, a wastewater treatment and collection system, an electric distribution system and a natural gas distribution system. In addition to serving City residents, these enterprise funds serve portions of Davidson County. The City also owns and operates a golf course. This report includes all the City's activities in maintaining these services. The City of Lexington also is financially accountable for the legally separate City of Lexington Board of Alcoholic Control, Lexington Tourism Authority, and Uptown Lexington, Inc., each of which are reported separately within the City of Lexington's financial statements. Additional information on these three legally separate entities can be found in Note 1.A. in the notes to the financial statements.

The City extends financial support to certain boards, agencies and commissions to assist their efforts in serving the citizens. Support is largely centered on partnership efforts to provide essential economic development and neighborhood revitalization. Among these are the Davidson County Economic Development Commission; Lexington Appearance, Historic Preservation and Human Relations Commissions; Edward C. Smith Civic Center; Lexington Housing Community Development Corporation; and Uptown Lexington, Incorporated.

The annual budget serves as the foundation for the City of Lexington's financial planning and control. For the City of Lexington, annual budgets are adopted for the General, Special Revenue (excluding Grant Projects), and Enterprise Funds. In addition, annual financial plans are adopted for all Internal Service Funds. Multi-year project budgets are adopted for Grant Projects Funds, the General Capital Improvements Projects Fund, and Enterprise and Internal Service Construction in Progress Funds. Appropriations are

made at the functional or project level within each fund. A function is a group of related activities aimed at a major service, such as public safety; a department is a component of a function such as police.

Local Economy

Internationally known artist Bob Timberlake, a Lexington native and resident, has a beautifully constructed gallery and welcome center just off Interstate 85 within the city limits. With Bob Timberlake established on the east side of the gateway entrance to the City of Lexington, Richard Childress anchors the west gateway entrance with a 65-acre winery complex, at the intersection of US Highways 64 and 52. Effective August 11, 2003, the property was voluntarily annexed into the corporate limits and the Childress Vineyards complex opened on October 14, 2004. Within the tract, 33 acres of the land are designated for cultivating grapes. With an investment of approximately \$7.7 million now ranking as the tenth largest taxpayer, the 35,000 square foot winery is inspired by the Italian Renaissance architecture of rural Tuscany. The winery includes a banquet hall that can accommodate 500, a bistro, a wine tasting room and gift shop.

Two phases of The Shoppes at Vineyards Crossing, retail pedestrian specialty shops modeled in the same Tuscan architecture with a view of the vineyards, were constructed and opened in the spring and summer of 2006. With minimal occupancy, The Shoppes were acquired by Richard Childress in July 2010 in an effort to increase tenant occupancy with plans to add a restaurant. In addition, construction broke ground in May 2007 to develop a Holiday Inn Express Hotel and Suites at the Vineyards, a complementary mid to upper scale hotel with 88 rooms, an indoor pool, business center, fitness facility, lobby furniture from the Bob Timberlake collection and a suite named for Richard Childress. The hotel was completed and opened in October 2008. The retail center has added a \$3 million dollar investment thus far; while the hotel has added another \$5 million dollar investment. With the Childress Vineyards tourism draw continuing to expand, the potential outlook is positive for future growth in tourism dollars.

The Uptown Lexington, Incorporated project began in 1993 when local property owners elected to tax themselves an additional \$.20 per \$100 assessed valuation to generate funding for the revitalization of the uptown business district. Investments of typically \$1 million or more a year have resulted in years past, with the total of public and private investment reaching approximately \$31 million to date. The Uptown organization is a member of North Carolina's Main Street Program, having won numerous awards over the years and earned a reputation as one of the top redevelopment programs in the state. The "Pigs in the City" campaigns, in which sponsors decorated fiberglass figures in colorful and witty themes for placement on the uptown sidewalks in past years, has garnered the City of Lexington national publicity. Uptown complemented the promotion of Lexington style barbecue and the annual Barbecue Festival for the past five years with a BBQ Capital Cook-off event held in April. Sanctioned by the Kansas City Barbeque Society (KCBS), the event has brought as many as 77 competitive teams, over 45,000 in attendance, and has included the taping of the finale of the national television show, BBQ Pitmasters. All six cook-offs were highly successful and the 7th Annual BBQ Capital Cook-off is slated again April 28-29, 2017.

All of the aforementioned efforts in combination with the 33rd annual Barbecue Festival in 2016 are helping to create a tourism platform for economic impact. The Barbecue Festival brings in close to 200,000 people to Lexington and is recognized as one of the Top Ten Food Festivals in the U.S. by *Travel and Leisure* Magazine and one of the Top Twenty Events for the month of October by the Southeast Tourism Society. It was featured in *People* Magazine in October 2009. In 2012, the *US News and World Report* ranked Lexington as #4 on its list of the best cities for barbecue, not to mention the annual Barbecue Festival event is listed in the book *1,000 Places to See in the USA and Canada Before You Die*. In July 2015, Fox News included Lexington among *11 sites that are distinctly American*. In September 2015, *Only In Your State* included Lexington as one of the ten best places to retire in North Carolina.

With significant economic losses in the furniture and battery manufacturing industries in the previous decade, diversification of the employment base and job creation is critical to restore the future of Lexington. Major industries have historically included tissue products, furniture and battery manufacturing, textiles, printing and banking. Halyard North Carolina (formerly Kimberly-Clark Health Care), a global healthcare products company, continues to be the City's largest taxpayer, with 6.11% of the City's assessed valuation. Moran Foods, Wal-Mart, Windstream, and Vitacost.com round out the top five at 1.57%, 1.25%, 1.16%, and 1.14%, respectively, of the assessed valuation. (Please refer to Table 12 for the Schedule of Principal Property Taxpayers in the Statistical Section for a complete list.)

In an effort to attract new industry, the City continues to support the Davidson County Economic Development Commission (EDC) and demonstrate a willingness to offer economic development incentive grants. Due to the EDC's efforts, in 2007, 2010, 2011, and 2012 the Thomasville-Lexington micropolitan area was ranked among the top micropolitan areas for economic development success by *Site Selection* magazine out of close to 600 micropolitan areas in the United States.

A major contributor to that ranking in 2007 evolved when the City offered an incentive grant to Arneg LLC, a privately held international company that manufactures refrigeration cases for retail and commercial outlets. The company is the third largest case manufacturer in the world with 16 manufacturing plants and 8 regional sales offices in 20 nations. In exchange for the five-year \$545,000 grant from the City, the company must invest \$20 million in the facility and create and employ 181 new full-time positions at an average annual wage in excess of 110% of Davidson County's average wage; conditions which they have failed to meet thus far despite healthy operations at the local facility. Construction of the Lexington plant, only the second production facility in the United States, was complete in July 2008. A key to the EDC ranking in 2010 was United Furniture Industries locating in Lexington in the spring of that year, with an expected gain of \$3 million capital investment in the facility and equipment and 150 new manufacturing jobs for the community over a three year period in order to qualify for the economic development grant. United Furniture Industries, a Mississippi-based manufacturer of moderate priced residential furniture, has exceeded the plant investment at over \$5 million and the jobs figure by adding 460 jobs at the plant, a former Stanley Furniture warehouse facility. The 2012 ranking is marked by the addition of the Save-A-Lot distribution center as described in further detail below.

The EDC maintains a data bank to provide information to industrial prospects and expanding industries such as Vitacost.com and Moran Foods (dba Save-A-Lot, Ltd.), of which a great deal revolve around the Lexington Business Center Industrial Park (LBC).

In March 1995, the City of Lexington, Davidson County and Energy United formed a project partnership to enhance economic development through building an industrial park. The goals established then for building the LBC were to build \$100 million in tax base in ten years, provide higher paying jobs, provide diversity in manufacturing and employment, and to the extent practical slow the migration of workers to other counties. During fiscal year 1997-1998, the LBC was granted Foreign Trade Zone designation along with five other sites in the "Piedmont Triad Area." Since the partnership agreement, the LBC has been fully served with water, sewer, natural gas, and electric utilities as well as road infrastructure. Three shell buildings were built and sold in Phase I of the development totaling to approximately \$30 million increased tax base. Chesapeake Printing, Masterbrand Cabinets, and internet-based wholesale nutritional supplement supplier Vitacost.com are the current tenants. In May 2010, Vitacost.com announced a \$6.7 million expansion to more than double the size of their facility with the commitment to add 228 jobs over three years, a significant increase from the 181 full-time permanent employees and 100 temporary workers in the manufacturing, distribution and customer service call center. With this expansion, Vitacost.com now ranks among the top ten taxpayers with approximately \$17.3 million assessed value or 1.14% of total city assessed valuation. (Please refer to Table 12 for the Schedule of Principal Property Taxpayers in the Statistical Section for a complete list.)

In November 1999, Phase II began when Energy United entered a contract to purchase an additional 20.382 acres to construct a fourth 100,000 square foot shell building. This facility was sold in August 2005 to Border Concepts, a manufacturer and supplier to the landscape and garden industry. The shell building along with the acreage resulted in a \$3 million investment. The company had outgrown its existing facility in Lexington with no more room to expand; therefore, the additional building offered the space to handle its product lines with some manufacturing, warehouse, and distribution operations performed in both facilities.

Additional activity at the Lexington Business Center has transpired over the past several years. Upon relocating from High Point, NC, Roehrig Engineering, a motor sports suspension development company, opened its 12,000 square foot \$1 million facility on a 2.8 acre parcel of land at the entrance of the industrial park in October 2005. Secondly, the City solidified plans to expand the business park by exercising a purchase option for 69.769 acres of additional land. The land purchase was made in December 2004 but has just recently developed into a twelve-year economic development land lease agreement negotiation between the City and Davidson County, and successfully resulted in luring Save-a-Lot to break ground in the business center in October 2010 with the promise of a \$20 million investment and 42 jobs over three years. Construction was completed in late calendar year 2011 and the final investment resulted in over \$23 million additional tax base. Save-a-Lot is an independent but wholly owned subsidiary of SuperValu Inc., a Fortune 100 company. Based in St. Louis, it is the nation's fifth largest grocery store chain overall with 1,200 food stores operated either corporately or by licensed retailers in 39 states; one of which is operated locally in Lexington.

With the revitalization of the uptown area, the potential tourism boosts, the strategic use of economic development incentive grants and the increased occupancy and expansions in the industrial park, it is anticipated that Lexington's economic base will be sustained somewhat despite the drastic losses in local manufacturing or further economic deterioration.

Long-Term Financial Planning and Major Initiatives

For the Year. The "Statement of Purpose of the Lexington City Council" outlines the value system for the City's efforts. The strategic values include the following: open communication with citizens, customers and employees; financial strength and integrity of City government; shift from government solving problems to community solving problems through citizen involvement and partnerships; City utilities and other enterprises to be operated in a businesslike manner; improve quality of life; and promote a strong, diversified economy. Aligning with this value system and focus toward the prioritized goals set by City Council at the annual retreat, the following projects and initiatives have been undertaken.

Community officials purchased and are now working diligently to spur redevelopment opportunities to prevent a vacated 18-acre uptown complex from becoming a negative blight on the community. When the former furniture plant was shuttered, the City took a significant step in attempting to control its own economic future by purchasing the Lexington Furniture Industries, Inc. Plant #1 property for \$1,000,000 with payments spread out over three fiscal years; the final \$200,000 of which was made in fiscal year 2008-09. LFI 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 and the newly renovated Lexington Historic Southern Railway Freight Depot. 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. Now commonly referred to as the "Depot District," this 18-acre property has financial impacts on current and future City budgets as the huge tasks of redevelopment begin via grant opportunities and private development commitment. However, it is considered a financial risk worth taking and grant funding for redevelopment plans are moving forward as discussed in the "For the Future" section below.

In May 2011, City Council accepted a \$645,000 grant through the Community Development Block Grant Economic Recovery Program administered by the NC Department of Commerce, Division of Community Assistance. This grant, which required no matching funds, provided for land acquisition, construction of a community shelter, a walking trail, playground equipment and landscaping at Erlanger Park. It also provided for the creation of a neighborhood center with a community shelter, playground equipment, benches and fencing at Green Needles Park. Work on these projects began during the 2012-13 fiscal year and was completed during the 2013-14 fiscal year.

For the Future. City of Lexington officials embrace the importance of shifting from government solving problems to community solving problems by stimulating more citizen involvement, empowering boards and commissions, and developing key partnerships. In October 2013, the City Council accepted and embraced *2020 Renaissance – A Strategic Plan for a Greater Lexington*. This strategic plan represents the completion of the 2020 strategic planning process and marks the third citizen-led strategic planning effort in Lexington, embodying the sentiment of “creating and intentional future.” The first strategic plan was developed between 1988 and 1991 and at that time proved to be the most successful citizen-led, long range planning effort to date in the history of the City with over 100 citizens involved and 22 recommendations made, 19 of which were accomplished. *Challenge 2000*, compiled by a committee of 27 members who began their work in April 1999, represented an extensive update of recommendations and has served as the City’s blueprint to over the last decade with a passionate focus on education, economic development and quality of life issues.

Unlike previous strategic plans for Lexington, the *2020 Renaissance* plan was not a continuation, nor was it built on the work of previous strategic plans. Instead, new Census data released from the U.S. Census Bureau in 2011 created the focal point for analysis. In anticipation of significant population and demographic changes from the 2000 Census data, City Management envisioned the importance of a fresh strategic planning process to better understand citizen needs for the community and to identify the “new face of Lexington,” and thus created an empowered citizen link to help craft the design and future work plan for meeting the needs of the community. The second primary objective for City Management with the third strategic plan was to solicit feedback from the citizens regarding satisfaction with City Government services. A goliath effort ensued to gather close to 500 participants in a citizen survey, which was deemed integral to fully assess the perceptions of City service levels. With these two key components as the research framework, the strategic planning process analyzed and ultimately identified key focus areas for government and partner agencies to rebuild a greater future for Lexington. The resulting *2020 Renaissance – A Strategic Plan for a Greater Lexington* includes recommendations in the following eleven focus areas: 1) Business/Job Developments, 2) Public Relations/Branding/Marketing, 3) Arts/Entertainment, 4) Depot District, 5) Education/Schools, 6) Health/Wellness, 7) Hispanic Population, 8) Neighborhood Stabilization/Community Design, 9) Population Growth, 10) Recreation/Community Centers, and 11) Transportation. More information, including the entire plan, can be found through the City’s website at www.LexingtonNC.gov.

Grant funding in the amount of \$700,000 for a TIGER II (*Transportation Investment Generating Economic Recovery*) award was accepted October 10, 2011 from the U.S. Department of Transportation, administered by the Federal Railroad Administration. The funds are being used to prepare construction and operational plans for a passenger rail station, platform and street cross sections, namely the Lexington Multi-Modal Transportation Station Area Plan. This work is described as Phase I of the overall redevelopment plan for the Depot District, formerly the LFI Plant #1 property. Funding is being sought for Phase II, which will serve as the master redevelopment plan to include construction of a passenger rail stop in the Depot District. During the 2014-15 fiscal year significant steps were taken to begin redevelopment of property in the Depot District. Several structures on this property were demolished and removed to prepare for redevelopment. In March 2016, Bull City Ciderworks moved most of its production operations to Lexington, where it became the first tenant of the Depot District.

In August 2013, the City of Lexington completed a Parks and Recreation Facility Development Master Plan. Recognizing the importance of parks and recreation to quality of life for the citizens of Lexington, this plan provides a ten year vision (2013-2022) for improvements to the City's facilities and parks and can be found in its entirety through the City's website at www.LexingtonNC.gov. At the 2014 annual City Council Retreat, the City Manager introduced the "Re-creation of Recreation" master plan as a vision to restore recreational facilities and enrich the community's recreational opportunities, addressing the City Council goal to "*expand recreational opportunities for citizens.*" This vision was incorporated into the 2014-15 budget planning process and in August 2014, the City acquired a facility that will be developed into an indoor recreation facility during the next three to five years. Reconstruction and renovation of Hillside Pool and pool house, a community pool, began in the fall of 2014 and concluded in the spring of 2015 with the opening of Lexington Aquatics Park. Construction began on the redevelopment of Washington Park and improvements to Holt-Moffitt Baseball Park in the spring of 2016 and is currently underway. Construction of the Breeden Insurance Amphitheater also began in the spring of 2016 in the Depot District. Plans are currently underway for the redevelopment of Radcliff Park into a skate park.

Comprehensive long range financial planning is essential to maintain the sound fiscal integrity of the City's financial position in an ever changing environment with issues on the horizon such as loss of revenues due to local economic conditions, escalating capital infrastructure needs and future economic development opportunities. These impacts affect the City's fiscal condition. The City's five-year Financial Planning Model are used to help discover future weaknesses. The analysis provided by the financial model and the prudent use of debt are used to help the City forge strategies to maintain the goal of a strong financial condition, while simultaneously ensuring professional service delivery. Therefore, the City is committed to updating the Financial Planning Model every year in concert with the City Council retreat and annual budget development. The biennial business plans for the utilities were completely evaluated and updated in fiscal year 2014-15 and will be updated again in fiscal year 2016-17. The plans identify and recommend ways to effectively deal with areas of uncertainty, reliability of utility infrastructure, and increased risks due to adverse changes in the local economy. Current factors necessitate that these plans be monitored and adjusted every two years to aid in long range scenario financial planning for the utilities, which represent over 70% of the annual operating budget. The City uses these plans along with the Financial Planning Model to adjust to various pressures in each of the utilities in future years.

In summary, the City will be focused on programs to meet the mission of the City which leverages City and grant resources and increases operational effectiveness, while maintaining basic City services. That being said, the City has adopted a "reserve the right to play" opportunistic strategy that necessitates cautious spending and efficiency maneuvers until economic conditions significantly improve.

Awards and Acknowledgements

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City of Lexington for its comprehensive annual financial report (CAFR) for the fiscal year ended June 30, 2015. This was the twenty-fourth consecutive year that the City has received this prestigious award. In order to be awarded a Certificate of Achievement, the government had to publish an easily readable and efficiently organized CAFR that satisfied both generally accepted accounting principles and applicable program requirements.

A Certificate of Achievement is valid for a period of one year only. However, we believe that our current CAFR continues to meet the Certificate of Achievement for Excellence in Financial Reporting Program's requirements, and we are submitting it to the GFOA to determine its eligibility for another certificate.

The preparation of this report would not have been possible without the skill, effort, and dedication of the entire staff of the Finance Department. I wish to express my sincere appreciation to all members of the

department for their team effort, dedication and hard work in preparing this report. In particular, I would like to mention and credit Kathy Whitman, Susan Floyd, Wendy Everhart, TJ Jackson, and Sarah Reece for their extraordinary efforts and contributions in conjunction with this report.

I would also like to express my appreciation and give credit to the Mayor, City Council, City Manager, and Assistant City Manager for their support and interest in providing the resources necessary to accomplish this project. In addition, I am grateful for support in planning and conducting the operations of the City of Lexington with utmost integrity in a responsible and progressive manner.

Respectfully submitted,

A handwritten signature in black ink that reads "John M. Overton". The signature is written in a cursive style with a large, stylized initial "J".

John M. Overton
Director of Finance



Government Finance Officers Association

**Certificate of
Achievement
for Excellence
in Financial
Reporting**

Presented to

**City of Lexington
North Carolina**

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended

June 30, 2015

Executive Director/CEO

City of Lexington, North Carolina Organizational Chart

