

## **BUDGET MESSAGE FOR FISCAL YEAR 2006**

Mayor McAlister and Members of Council:

Submitted herein, in accordance with the Local Government Budget and Fiscal Control Act, is the annual Budget for Fiscal Year 2006 for the Town of Cary. The budget is balanced and identifies methods of raising and spending funds for specific programs during the coming fiscal year. The budget is a plan that presents financial information by category of expense for each departmental budget and outlines the operations of the Town of Cary government and its component programs.

The approach of the FY 2006 Recommended Budget is to create a budget structure and philosophy that will expand on our use of basic business principals to guide decisions now and in the future. Our primary goal for the future is to provide high quality service at the lowest cost with a stable tax rate and fee structure. Our secondary goal is to regain our focus on providing traditional municipal services and expanding into areas of specialty services on a planned basis when resources are available.

The approach taken in developing the FY 2006 budget is necessitated by many of the budget and policy decisions made between Fiscal Years 2000 and 2004. During that period of time, the Town appropriated \$109 million in cash to develop parks, recreational facilities, and purchase open space including two major regional parks and a number of specialty facilities; \$150 million primarily in debt to widen critical thoroughfare sections and Town facilities, which is a primary reason debt service increased from \$1.6 million to \$15.1 million per year by 2007; created new and expanded programs and services (e.g. traffic signalization, C-Tran); and funded services that have historically and legally been the responsibility of other levels of government such as providing \$5.3 million for school operations, \$1.5 million for the purchase of school sites. Also the Town has committed \$40 million to fund roads and utilities infrastructure for new developments in exchange for developers agreeing to pay school impact fees. Prior to FY 2000, these same infrastructure costs would have been paid by developers.

While some of these decisions resulted in substantial one time capital expenses, the decisions to provide new major parks and recreation facilities; specialty facilities and new programs significantly increased ongoing operating costs, including personnel, equipment, and contracted services. During this period, the Town's general fund debt grew from \$30 million to \$143 million and the annual debt service payments rose from \$1.6 million in FY 2000 to \$12.2 million in FY2006 with a peak of \$15.1 million by FY 2007 for debt appropriated prior to this budget year. The Town's other operating expenses grew by \$35 million, or 77%, in order to operate and maintain the new facilities and programs and to maintain previously existing levels of service to an expanding number of customers.

At the same time these expenditure decisions were made, the Town reduced solid waste fees and taxes, and implemented growth management policies designed to limit population growth. These decisions helped reduce the rate of tax base growth occurring in Cary, limit population growth, and reduced major revenue sources. During this period of time the property tax rate was decreased by one cent and the solid waste fee by one third in response to the Town's strong revenue growth during the decade of the 90's and the existence of higher than normal fund balances. This resulted in saving the citizens and taxpayers of Cary \$10.5 million in taxes and fees. The combination of rapidly escalating expenses and slowing revenue growth has created the need to evaluate how we provide basic public services, who pays for them, and how we re-establish the service and financial priorities of the Town. The approach taken to develop the FY 2006 budget focuses on the following goals:

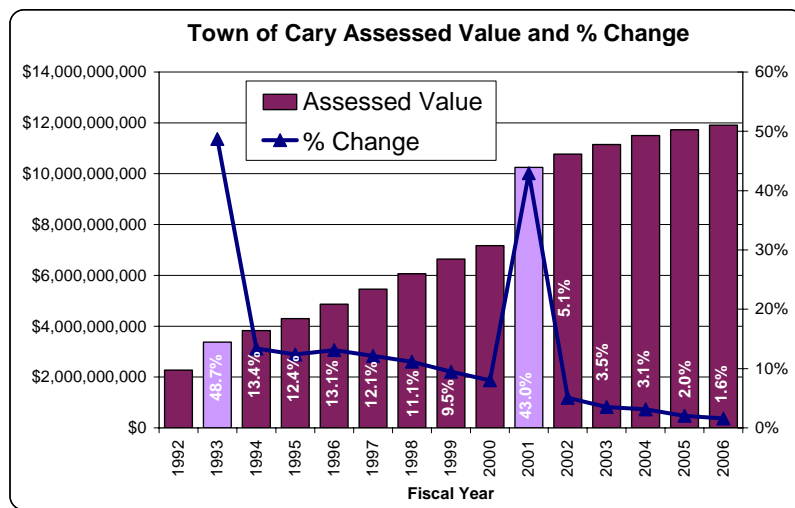
(1) Identify the services that are important to citizens of the Town of Cary (2) Adopt acceptable levels of service that help control escalating costs for the future (3) Review changes in services and service levels that will help reduce costs (4) Identify capital expenditures that will minimize new debt, but allow the Town to make progress toward meeting our long term master plan goals in a prudent manner.

# MAJOR ISSUES

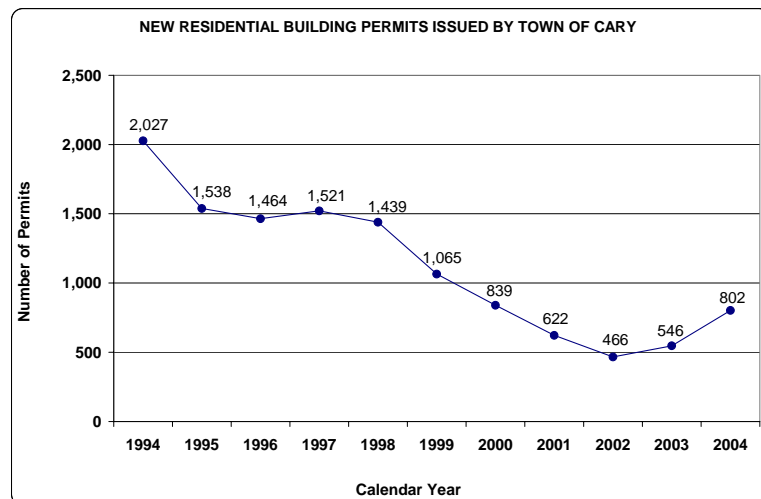
## Tax Base Growth

The recent impacts of the poor economy, coupled with the Town's successful growth control measures, have combined to slow the rate of revenue growth in recent years compared to that of the mid to late 1990's. Approximately 71% of the Town's tax base is residential in nature, so reductions in the population growth rate have a significant effect on the level of ad valorem tax revenues. This is the largest revenue source for the Town and, at \$49 million, it comprises 53% of all General Fund revenues. Growth in ad valorem receipts is expected to be only 1.6% in FY 2006, compared to the average annual growth rate of 12% from FY93 to FY02. The recommended budget for FY 2006 maintains a tax rate of 42 cents per \$100 of assessed value.

A historical perspective of the Town's assessed value (tax base) growth since 1992 is provided in the graph below. The extremely high growth rates in 1993 and 2001 reflect the property revaluation which is done every eight years in Wake County. During those years, the tax rate was reduced to maintain a revenue neutral tax rate. The next property revaluation is scheduled for 2008 which will impact tax base projections for fiscal year 2009.



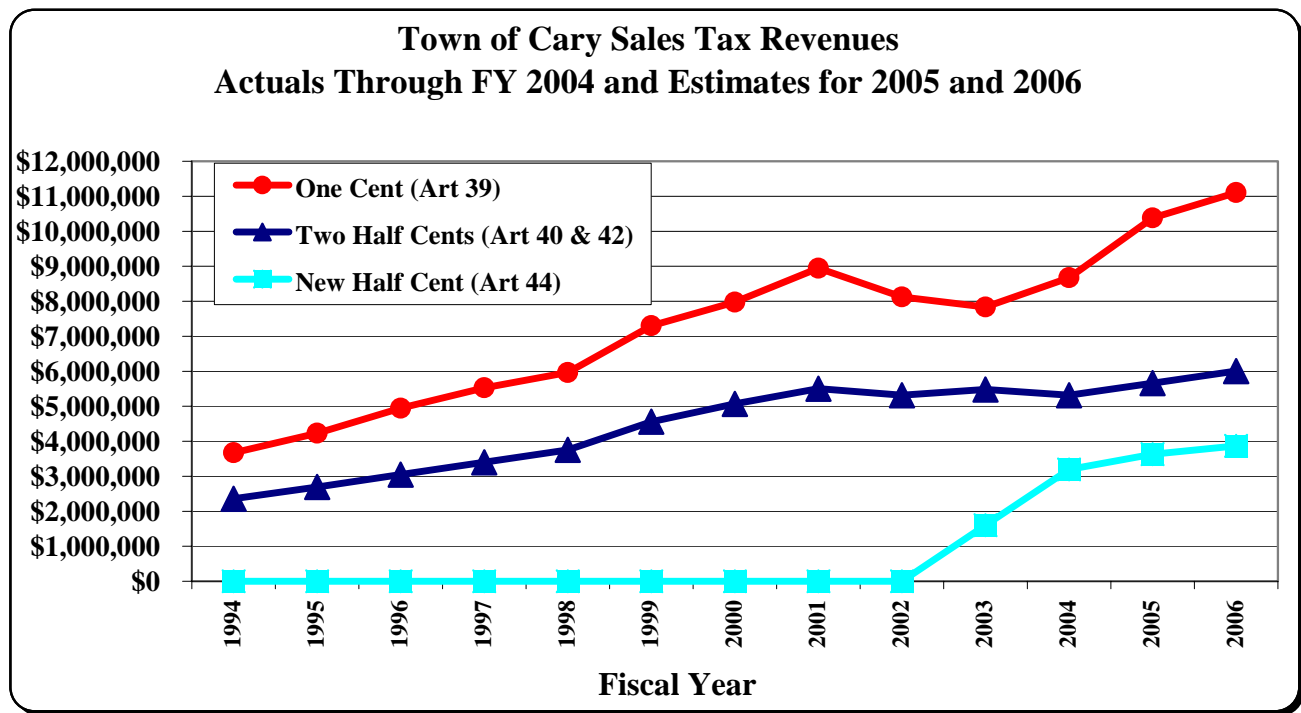
The Town has started to see an increase in the number of new single family (SF) permits being issued recently. During 2002, only 466 new permits were issued compared to an average of about 1,500 per year in the mid 90s. The assessed value on which tax receipts are calculated is based on what has been built by the prior January 1 meaning that FY 2006 revenues are based on values as of January 1, 2005. While Cary's tax base is much higher than it was in the mid 90s and it takes more growth each year to have the same percentage increase, these higher numbers of new permits will help the tax base grow over time as the units are built and included in future tax base calculations. The graph below shows new single family residential permits issued over the past decade.



## Sales Taxes

Sales tax revenues totaling \$21 million in FY 2006 make up 23% of all General Fund Revenues. The historical growth rate of this major revenue source was greatly impacted by the economic slowdown of the early 2000s, but the current economic recovery has helped this revenue source recover in FY 2005 and growth is expected to continue into FY 2006. Cary has experienced a slower growth rate in this revenue than some other jurisdictions in Wake County. Sales taxes are distributed within Wake County on a per capita basis. As Cary's population growth rate has slowed compared to the rest of Wake County, it receives a smaller portion of the total distribution amount. Had Cary's percentage distribution remained constant since its peak in FY 2001, Cary would be receiving about \$700,000 more in FY 2006. Despite this smaller distribution share, the economy's signs of recovery and increases in consumer confidence are expected to yield a healthy growth of 7% in sales tax. This follows a tremendous rebound in revenue growth expected in FY 2005 over that of FY 2004 of \$2.4 million or 14%.

The graph below depicts the historical growth of sales tax revenues and includes the one cent (Article 39) which is distributed based on sales delivered in Wake County, the two half cents (Articles 40 and 42) which are distributed state-wide based on the population of each county, and the one half cent (Article 44) which is distributed based on a combination of both approaches mentioned. Article 44 was approved in December 2002 to replace the expiring Inventory Tax Reimbursement and Intangibles Tax Reimbursement revenue sources.



## Solid Waste Program

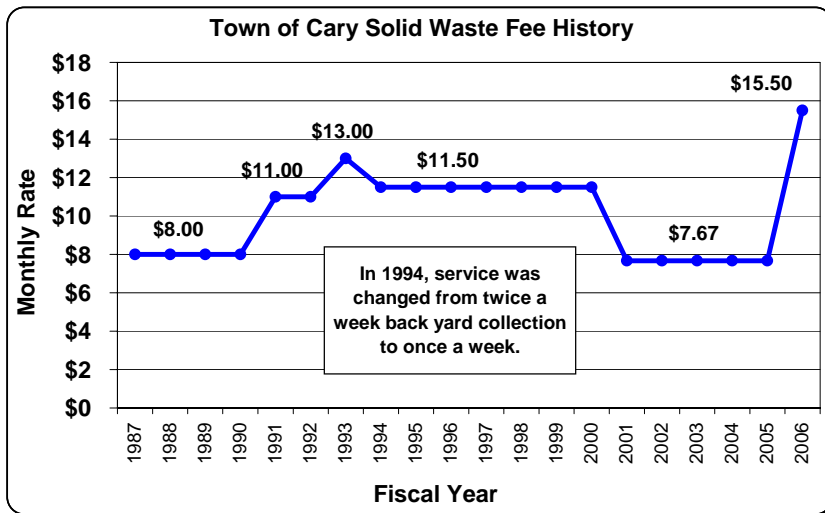
### Service Levels

The Town's solid waste program provides service to all residences in the Town and any small businesses that choose to have the Town provide their solid waste services. The Town does not offer these services to commercial enterprises that generate a high volume of solid waste. There has been considerable discussion over the past decade about whether the premium service level of backyard garbage collection is worth the extra cost. The Town of Cary is one of the only remaining large municipalities in North Carolina that has continued to provide backyard service, most have shifted to a curbside collection system to manage costs. As part of the FY 2006 budget, staff has re-examined the solid waste program and recommends converting to automated curbside service to help manage the growing costs of service provision. Under this program, the Town will provide customers with a roll-out cart that is placed at the curb for collection. Then a single driver in a truck with an automated arm picks up the cart and dumps

it without the driver leaving the vehicle. This system is much more efficient and safer than the current system, which requires a crew of four people. This recommendation maintains the current yard waste collection process, but the day of collection will be the same day as garbage collection rather than on Monday as in the current system.

### Fees For Services Provided

The Town of Cary currently charges \$7.67 per month to each customer to help offset costs associated with solid waste collection including garbage, recycling, yard waste, and leaf collection. The solid waste and recycling monthly fee history since 1987 is included below.



The percentage of program cost recovery has varied over the years and is expected to be 45% during FY 2005. At this monthly rate, 55% of the program costs are being subsidized by other general fund revenue sources, including the entire tax base (both residential and commercial). The rate of \$15.50 is expected to recover about 86% of the total program costs from the customers receiving direct services and includes the costs of actually collecting and disposing of the garbage, recycling materials (net of revenue received from selling recyclable materials), and yard waste. The remaining 14% of costs are recommended to be funded by other existing general fund revenues (including the tax base) as they benefit the community at large and include services such as the Dixon Avenue convenience center, Town-wide litter collection and code enforcement activities, and the disposal of wastes generated by Town activities. The details necessary to execute this new program, including the timing and related communications plan will be shared with the Town Council through budget worksession materials and related staff reports.

To better isolate the costs of providing this service and the related revenues necessary to fund its continuing operations, it is recommended that a new enterprise accounting fund be established specifically for the solid waste program and that all related costs be removed from the Town’s general fund. The details reflected in the recommended budget ordinance, fund summaries, this message, and related discussion materials currently reflect all related costs and revenues in the general fund for comparability and to help identify the key issues present in the FY 2006 budget.

The staff evaluated funding solid waste services through the property tax and rejected that alternative for the following reasons. The Town chose to make the costs of solid waste collection and disposal subject to a user fee at the time the Town stopped providing that service to businesses and industries because the costs had become prohibitively expensive. The decision was made to only provide residential waste collection with the users paying the costs through a user fee. Since businesses and industries were not getting any service, the user fee provided the mechanism for the costs to be borne by the users and not adding to the property tax burden of those not getting any service. If the town was to cover the costs of the residential solid waste collection and recycling service through the property tax, it would require a tax increase of approximately \$0.08/\$100 valuation (19% of today’s tax rate) for every tax payer, including those not receiving any service. The negative financial impact on businesses receiving no

service would be significant. In addition, since they receive no service for this increase, it creates a severe service inequity which the Town has always, as a matter of policy, tried to avoid.

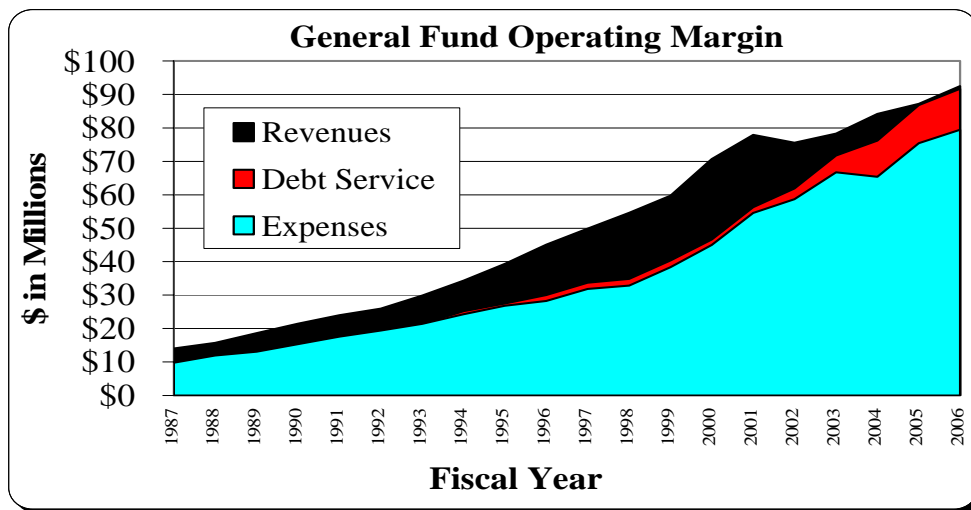
## Investment Earnings

Existing cash balances on hand due to current receipts, fund balances, and project funding are often invested temporarily to earn the Town income in the form of investment earnings to help offset total income needed for Town services. While the sagging economy of the past few years has driven debt service rates lower in the bond market, it has also reduced the amount of return available for the Town’s investments. Interest earnings in FY 2002 were \$9.4M across all major funds, while expected net investment earnings for FY 2005 in these same funds is only \$2.4 million, which is a drop of \$7 million or 75%. As these market changes have affected the Town’s income over the past few years, the Town has had to adapt its expense and pay-as-you-go capital planning accordingly. If the expected average yield rates of 2.2% in FY 2006 materialize, total investment earnings should be about \$70K higher than those expected in FY 2005.

## Maximizing Existing Resources to Continue Advancing the Quality of Life

### Operating Margin

The slowing growth of some revenues and decline of others, increasing operational expenses, and increasing debt service costs have combined during poor economic times to present an increasingly challenging budget scenario over the past few years. Ad valorem revenue growth, reflecting real property assessed as of January 1, 2005, is expected to be only 1.6% higher than the previous year. This small increase continues the steady drop in the rate of growth in Cary’s tax base. This is significant in that operating margins from FY92 through FY02 averaged nearly \$15 million annually. As the graph below illustrates, the rate of debt service growth (in red) and steadily climbing expense growth (in blue) has put increasing pressure on the rate of revenue growth (in black). Operating margin is demonstrated in the graph by the area where the revenues, shown in black, are still visible since they exceed debt service and expenses. The recommended budget reflects an operating margin of approximately \$895K or just under one percent.



Of the \$12.2 million in debt service payments due during FY 2006, \$1.3 million is related to the widening of North Carolina Highway 55 which is currently being performed by the North Carolina Department of Transportation (NCDOT). The widening of this roadway was originally planned to take place in FY 2007 as a state funded project, but the construction time frame was advanced to take place sooner when the Town of Cary initiated a loan

agreement with the state for \$15.4 million. Under the agreement, the state will reimburse the Town of Cary for the amount of the loan in FY 2007, when the originally planned funding is scheduled to be available. Options available at that time include paying off the related debt with the cash payment from the state or to continue paying the annual debt service and using the cash to fund future transportation capital projects. A key variable that will help make this decision will be the rate of interest being charged for new debt at that time versus the interest rate currently being paid on the original loan.

### **Debt Capacity**

Fiscal Year 2003 marked two significant milestones in Cary's debt history. At the beginning of FY 2003, the Town appropriated the remainder of its bond authority for streets and park facilities that was approved by the voters in 1999 (\$63 million for streets and \$10 million for parks). Realizing that the Town intended to continue improving street capacity and park facilities, the Town held the largest combined municipal bond referendum in North Carolina in 15 years: \$130 million for streets and \$30 million for park facilities. In 2005, Cary continued its tradition of ensuring infrastructure is in place when needed by beginning to execute plans for a major water reclamation facility that is necessary for future capacity and to meet an inter-basin transfer certificate agreement to return water to the Cape Fear River basin by 2011. This project is being undertaken regionally and includes as project partners the towns of Morrisville, Apex, and Holly Springs. To help finance the Western Wake Regional Wastewater Management Facility (WWRWMF) in the most affordable manner, Cary held a \$110 million general obligation bond referendum which was approved by Cary voters. Included on the same ballot was an additional question for voters regarding \$10 million in general obligation bond authority for the purchase of open space which was also approved.

### **Debt Affordability**

With \$160 million in newly approved debt authority for streets and parks comes a great deal of responsibility. The cost of borrowed money remains relatively low compared to historical levels. While low interest rates are a great incentive to leverage the Town's remaining debt capacity, being able to repay the related debt service each and every year is a major factor when deciding which projects to undertake and how much to borrow. Debt service related to the 1999 bond authority for streets and parks, costs related to the NC55 widening and an expansion of Town Hall have combined to increase debt related costs in the General Fund by \$10.6 million, or 670%, to \$12.2 million in FY 2006. General fund debt service is expected to increase further to \$15.1 million by FY 2007 related to capital projects approved prior to the FY 2006 budget.

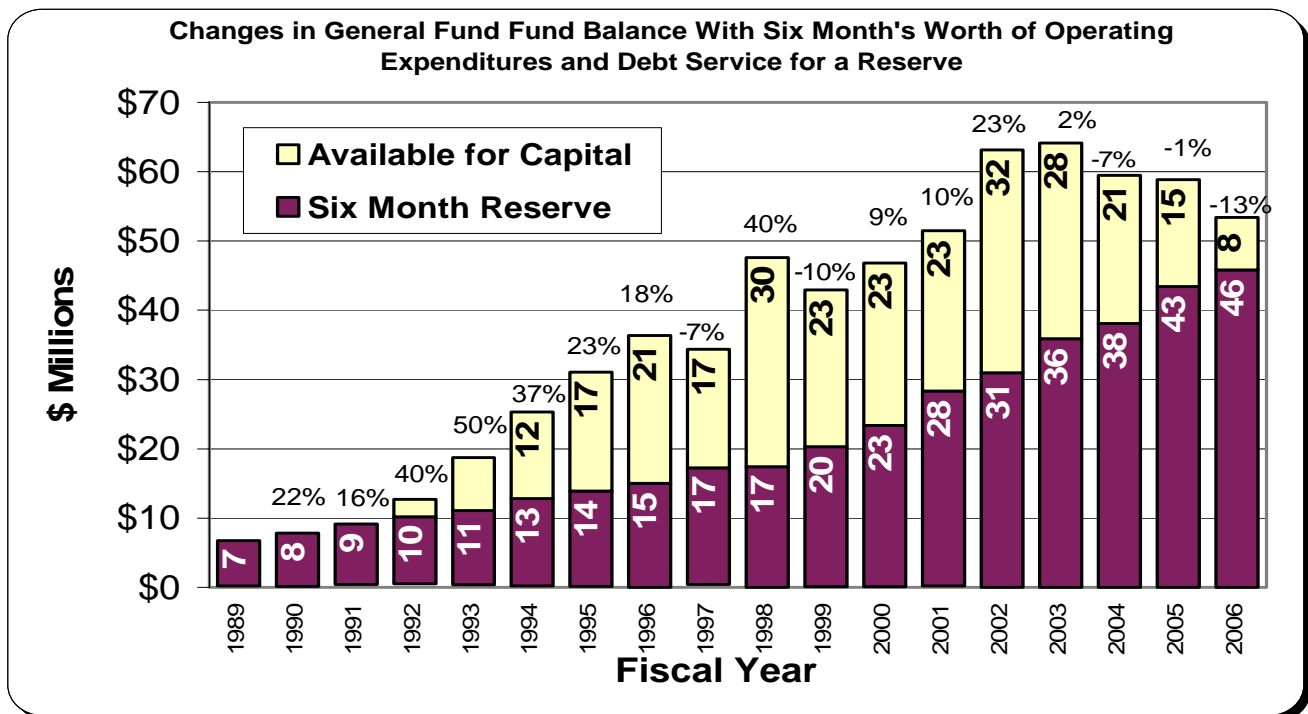
The declining rate of revenue growth in both operating and capital reserve funds is of major concern when evaluating the future ability of the Town to afford additional debt service and other operational increases. For this reason, the Town has chosen to limit the amount of debt authority planned in any given year to no more than 1/7<sup>th</sup> of the total bond referendum amount (\$18.6 million for streets and \$4.3 million for parks). If all the authority were to be needed over the next seven years, this approach would help spread the debt service burden evenly allowing the economy more time to recover and for the Town to ensure a proper balance between revenue and expenditure growth.

Prior to the FY 2005 budget, the Town appropriated \$26.5 million of the street authority and \$4.3 million of the park authority. The adopted FY 2005 budget included no additional appropriations for streets or parks. Based on identified project needs and other available funding sources, the recommended general capital budget for FY 2006 includes \$15.3 million of street and \$4.3 million of park bond authority. These comparatively low levels of debt funding are being recommended to help reduce operating margin deficits that are projected in the near future should additional revenue growth not materialize. The Cary Town Council has already conducted two capital worksessions to help evaluate new projects requested for funding and has indicated a desire to limit new debt appropriations where possible while considering possible reallocations of previously authorized funding. These adjustments will continue to be reviewed and changes will be incorporated as part of the adopted FY 2006 budget.

Signs of an economic recovery have begun to materialize in Cary in the form of increased levels of new residential construction and sales tax growth. How quickly the higher construction permit volumes of today translate into new tax base as of January 1, 2006 (which will determine ad valorem revenue projections for FY 2007) and just how much sales tax revenues continue to grow will be key indicators of how strongly the Town will be forced to evaluate additional funding options in FY 2007 which could include tax increases.

## Fund Balance

The Town of Cary's fast growth during the 1990s helped develop one of the highest levels of General Fund fund balance in the state of North Carolina. This major cash reserve created by historically healthy annual operating margin has helped facilitate a large number of cash funded projects as well as provide mid-year funding flexibility regarding special opportunities and emergencies. The Town Council decided during FY 2003 to reserve six months worth of operating expenditures and debt service for future needs, while designating the remainder for pay-as-you-go capital projects or for special opportunities versus the funding of on-going expenditures. During the FY 2004 budget process, the Town appropriated \$12.6 million of this designation to help fund the capital program including \$8.5 million for the USA Baseball facility and \$5 million for an aquatics center. At the end of FY 2006, it is expected that approximately \$8 million of General Fund fund balance over and above the six month target of \$46 million will be available for capital expenditures or other opportunities. While fund balance levels are a key consideration when bond rating agencies (Moody's, Fitch, Standard & Poor's) evaluate the risk associated with future borrowings of the Town, there are many other factors considered as well. Such items that are considered heavily when considering awarding Cary's AAA rating include evidence of a strong and proactive administration, effective debt management with moderate to low debt levels, a vibrant or diverse economy, and strong finances. As future capital opportunities arise and various financing options are considered, fund balance targets and appropriations should be considered as a viable option for a one-time funding source, realizing that it is extremely difficult to replenish, especially during tough economic times and periods of slow tax base and population growth.



## Impact of Declining Operating Margin

Fiscal Year 2006 represents a very interesting mix of several factors that have affected operating margin over the past several years:

- Revenue growth from new tax base is minimal as a result of the economy and growth management efforts

- Operating expenditure growth has been limited to maintaining service levels in most areas other than staffing, operating, and maintaining several new facilities (Tennis Center, Skate Park, SAS Soccer Park)
- Significant operational expenditure growth is expected due to capital facilities coming on line during late FY 2005 and FY 2006 (fiber optic traffic signal system, Town Hall Campus, Biosolids dryer)
- Debt service in FY 2006 is projected to grow by \$785K and another \$3 million in FY 2007 to help fund projects budgeted prior to FY 2005 (there is often a delay between the time a project is approved and when the cash is actually needed to pay for construction – debt is not sold until just before the related cash is needed). By FY 2007, General Fund debt service is expected to exceed \$15 million in total, which will represent about 16% of all General Fund requirements.

While healthy levels of General Fund fund balance exist to assist with capital purchases and one-time emergency situations, it is not a sound financial planning practice to pay for long term operational expenditures with fund balance. This is especially true when current forecasts indicate as much as a \$6 million deficit for Fiscal Year 2007. While there has been an upturn in the number of new residential permits being issued, there is some question as to how much of that pending construction will be in place for property valuation by January 1, 2006 and just how much it will impact revenue growth for FY 2007.

### **Options for Creating Additional Operating Margin**

A major cause for decreased levels of operating margin over the past decade is the growing amount of debt service that has been absorbed within the General Fund with no tax increases. In fact, the tax rate was reduced by one cent in FY 2002, which is equivalent to about \$1.1 million less in annual revenue. Since Fiscal Year 1994, four bond referendums have been approved by the voters authorizing \$242 million of general obligation debt for streets and parks with the understanding that the potential tax increase resulting from all of that debt could be as much as 14 cents on the tax rate once all the debt is issued (all tax rate impacts here have been adjusted for property revaluation impacts in 2000). Up to and including the FY 2005 adopted budget, \$109 million, or 45% of that \$242 million has been appropriated to various street and park projects. Unless other revenue growth rebounds dramatically in the next year or so, which is not currently anticipated, it is very likely that some portion of the tax increases related to these bond referendums will need to be instituted in the coming years to help pay the respective debt service.

As part of this budget, staff has developed and is recommending service and fee recommendations related to the Town's current solid waste and recycling program. The monthly fee was reduced from \$11.50 per month in FY 2001 to the rate of \$7.67 per month, which is still in effect today. The current fee of \$7.67 per month is expected to generate about \$2.9 million in FY 2005 which will recover less than half of the related costs. Please see the topic of "Sanitation Program" discussed earlier in this letter for more information.

## **The Balance Between Revenue Growth and Expenditure Growth**

Historically, the NC General Assembly has given local governments a limited range of responsibilities for services and capital facilities and a limited set of revenue sources to meet those responsibilities. Over an extended period of time, local governments need to develop and maintain a focus on community priorities within the limits of their responsibilities. Having this prioritization structure and focus assists local governments in the struggle to balance revenues and expenditures as well as maintaining a strong and stable financial position.

During the decade of the 1990s, the Town of Cary benefited financially from the booming economy and an exceptionally high growth rate in both population and assessed value. Many of the Town's major revenue sources are largely driven by population such as ad valorem taxes, building permits, sanitation fees, recreation fees, cable television franchise fees and vehicle license fees. Other major revenue sources driven by population that are actually distributed through the state or county on a per capita basis include sales taxes, wine and beer taxes, and Powell Bill funding for local street improvements. Due to Growth Management efforts and a slowing economy, both the Town's population and revenue growth have slowed dramatically in recent years. One of the benefits of the high growth levels was large amounts of operating margin (revenues less expenses) that enabled the Town to self-fund many large projects and new priorities. For example, from FY 1998 through FY 2002, the Town was able to fund \$130 million, or about 52% of its entire General Capital Program with cash generated either from operating margin, grants, or capital reserve revenue sources. Over the past few years, however, the tax rate has been reduced

by one cent (worth \$1.1 million in FY 2006) and the solid waste fee has been reduced by one-third (worth \$1.4 million in FY 2005). These revenue reductions have been coupled with significant service level increases in the form of new appropriations to roads, parks, specialized facilities, economic development funding for schools, affordable housing, and the initiation of a transit program. In addition to the initial capital costs to build many of these facilities, some of them require additional staffing to maintain and program their use. General Fund operating expenditure and debt service growth in FY 2006 are expected to have increased by \$28.9 million or 47% since FY 2002. Over that same time period, General Fund revenues are anticipated to grow by only \$17 million or 23%. This disparity between the level of revenue and expenditure growth over the past five years has effectively eroded the \$24 million annual operating margin that existed in FY 2000. Without significant shifts toward increasing revenues through growth, increases in existing fees, or decreasing expenditures in the very near future, the excellent financial condition of the Town can only be maintained by a significant increase in property taxes.

Town staff has a history of being very frugal in its application of new resources to accomplish both existing and new tasks by never adding people or new funding until it is absolutely necessary to achieve the Town's goals. In addition, there is recognition within the organization that most often, people are the most expensive solution to any problem. Many of the recent privatization efforts the Town has undertaken and studies related to operational improvements and efficiencies were detailed very thoroughly in the series of Operation Worksessions held with Council during the Fall of 2004. In response to the dynamics of the past five years, the staff has taken an even harder look at operations to help reduce and control costs and examples of some of these initiatives are identified below:

- Reduction of eight positions in Inspections & Permits (5 inspectors, 3 permit staff) when the number of new permits being issued dropped in 2003
- Residential plan review position held vacant pending complete program assessment
- Did not fill Recycling Coordinator vacant position (reassigned the majority of duties and increased a 30 hour position to 40 hours to handle the remaining workload)
- Reduction of two position in Engineering (development inspections manager and projects administrator)
- Contracting janitorial services, landscaping, right of way and town facility mowing
- Reduction in the minimum staffing on aerial ladder units in the Fire Department from 4 to 3
- Change in approach to rising Health and Dental Insurance costs by encouraging more consumerism
- Not filling a Budget Technician vacancy in the Budget Office
- Consultant studies on operations and staffing efficiencies at all utility plants and fleet operations
- Reallocating four sworn officer positions from elementary school resource officer positions to higher priority objectives (two to new 9<sup>th</sup> grade centers, one to patrol and one to investigations)
- Class and pay study approach changes to not have associated automatic increases with grade changes (cost of implementing this year's program is 10% of that four years ago)
- Required a 10% reduction across the board in training and travel expenses for FY 2006 after holding amounts flat for the last several years
- Required a 3% reduction across the board in non utility operating and maintenance expenses for this budget

## **GENERAL FINANCIAL CONDITION OF THE TOWN**

FY 2006 budget recommendations have been made relative to the current overall financial condition of the Town and to the goals set by Council for the future financial condition of the Town. The Town's financial condition continues to be above average, according to the rating agencies, currently providing adequate liquidity despite growth pressures and a slowly recovering economy. All three major national bond rating agencies have awarded the Town of Cary their highest possible rankings, a move that reaffirmed Cary's financial strength by Moody's and Fitch, which rated Cary Triple-A in 1998. Standard & Poor's also decided to raise its 1998 rating of Cary from AA+ to the coveted Triple-A. These ratings allow the Town to save tax dollars when borrowing by gaining lower interest rates on bond issuances.

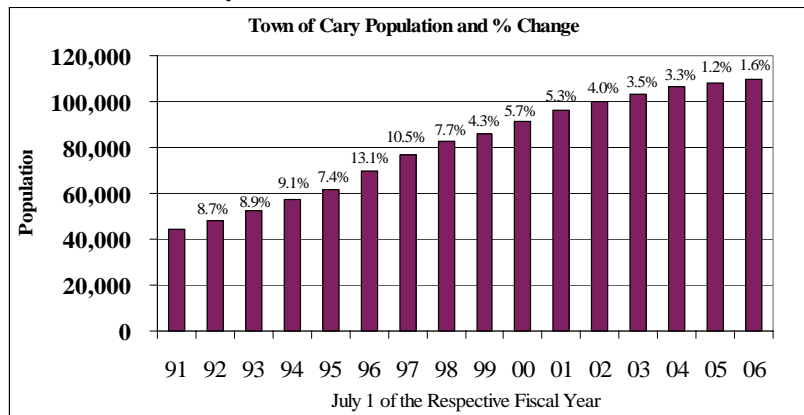
The Town has maintained a strong cash position, and property tax revenues consistently increased during the 1990s, allowing the Town to avoid property tax rate increases since Fiscal Year 1990. Since then, any adjustments to the tax rate have been for revaluations, except in FY 2002, when the tax rate was dropped by one cent from 43 to 42 cents per \$100 of property valuation. While revenue growth has continued, a decrease in the growth rate has been experienced. Past strong population and commercial development has resulted in the need for a sizable and aggressive capital improvements program for both general and utility needs. Due to these growing infrastructure needs and reduced growth rate, the Town can no longer depend on its financial reserves to the extent it has in the past. Alternative financing options must be sought which will enhance funding flexibility and continue to ensure cost effectiveness. While the Town has traditionally funded major capital needs with cash, recent plans to leverage the Town's borrowing power by increasing the use of debt financing are evident with the resulting increases in debt service during the past few years and looking forward to both fiscal years 2006 and 2007. Although current financial reserves are adequate to temporarily sustain operational needs, their ability to fund significant capital requirements in the future will be minimal. These changes will affect future operating budgets with increased debt service and investment income fluctuations reflecting shifts in cash balances. Acquiring additional debt without existing margin will require some combination of tax increases, additional revenue sources, and/or expenditure reductions to create the amount of margin necessary to service the new debt. This situation is expected to occur as early as FY 2007 if current economic trends affecting population and tax base growth do not change.

The Town's strong financial reserves have provided significant flexibility in the past allowing the Town to move quickly to take advantage of economic opportunities and/or begin new projects in the middle of the year. Plans for the Town's financial actions should include consideration for maintaining flexibility for periods of both economic growth and downturns.

## REVIEW OF REVENUES

### General Fund

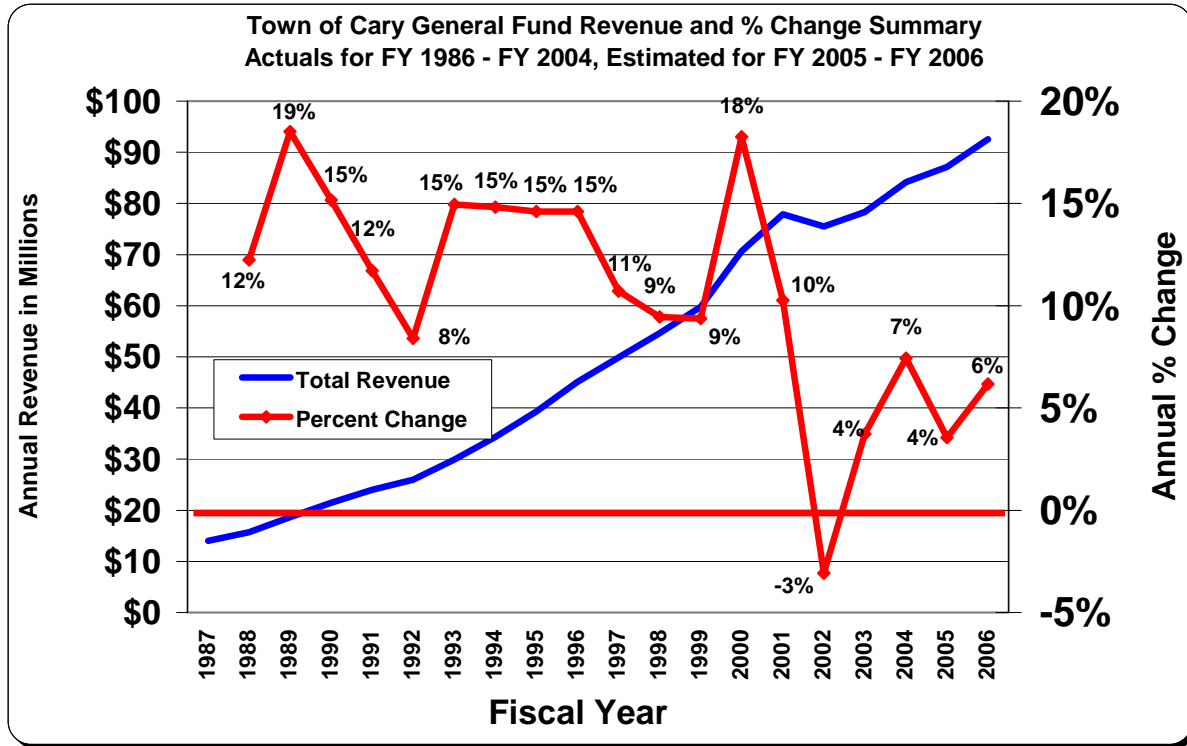
Cary's rate of population growth has slowed to an estimated 2.1% as of July 1, 2005 after the double-digit growth experienced during much of the 1990s. While a slowing economy and growth management practices have combined to encourage a slower growth rate, continued growth management efforts are expected to aid the continuance of that trend after the economy recovers.



Revenue assumptions have been developed according to the effects of the economy and the growth management initiatives on the Town's revenues such as population, assessed value, and building permits. Some of the specific revenues affected are ad valorem taxes, permit and inspection fees, solid waste fees, sales taxes, utility franchise tax, wine and beer tax, inventory reimbursement tax, cable TV franchise fees, and recycled goods.

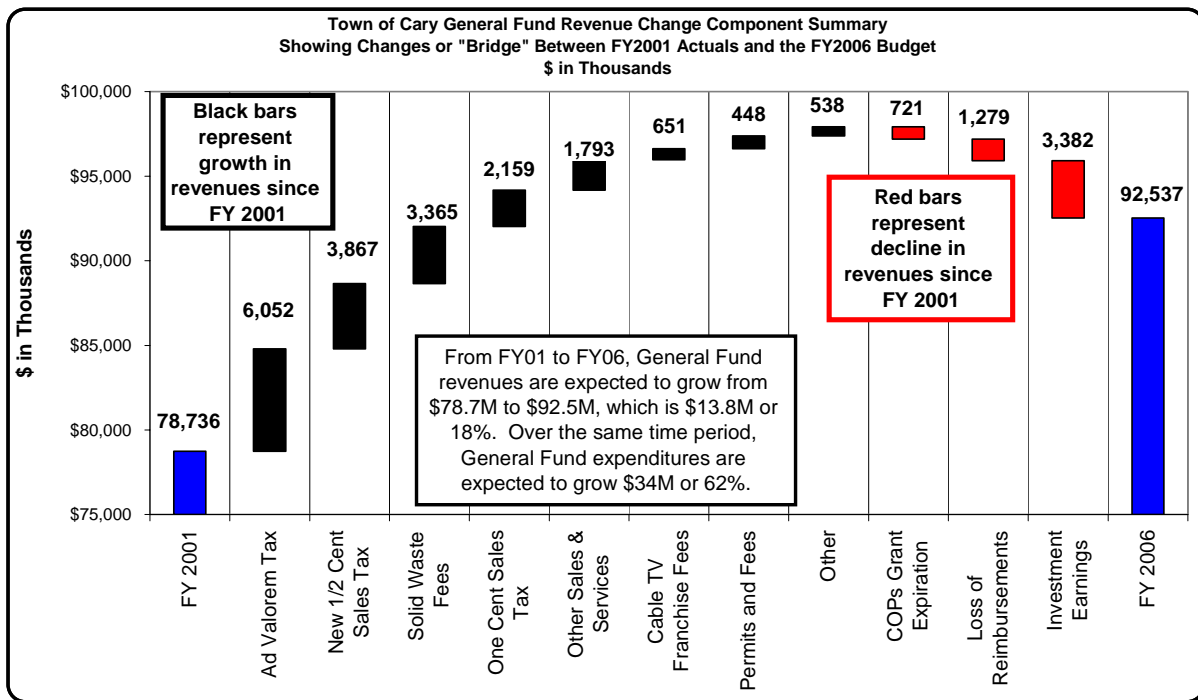
The General Fund Revenues for Fiscal Year 2006 total \$92.5 million which is a 6% increase versus estimated revenues for Fiscal Year 2005. This growth rate is bolstered by the recommended change in the solid waste fee from \$7.67 to \$15.50 per month which is expected to generate an additional \$3 million in FY 2006 to help refocus attention on this as a service to specific customers and restructuring its related cost recovery philosophy. Without this fee increase, total general fund revenue growth would only be about \$2.4 million or 2.7%. The graph below

demonstrates the consistent and substantial year over year growth during the 1990s that has changed dramatically over the past several years.



The Town's major source of revenue for FY 2006, the property tax, is based on January 1, 2005 assessments, which are projected to increase 1.6% over the estimate for FY 2005. The Cary Town Council sets the tax rate, currently 42 cents per \$100 of assessed value, each year as part of the budget process. The tax rate for the year becomes official when the new budget is adopted annually in June. The Adopted tax rate for FY 2002, 42 cents per \$100 of assessed value was one cent lower than the 43 cents rate approved for FY 2001. The tax rate for Fiscal Year 2006 is recommended to remain at 42 cents per \$100. The marginal growth in assessed value will help provide funding to continue essential services at current levels in the Town's General Fund. The tax base in FY 2006 is estimated at just over \$11.9 billion, which includes real and personal property. The 42 cent rate is expected to provide \$49.4 million in revenue. One penny on the tax rate generates approximately \$1.2 million in revenue for the Town.

For the Town of Cary, the focus is also on the local issues and the effects of growth management on our ability to maintain our revenue streams. Cary was able to get credit for its fast pace of growth during the 1990s by having a special census done in 1998 which increased its official population count relative to other municipalities in the county. However, the 2000 decennial census has caused a reallocation of the distribution of sales tax revenue from retail sales. The Town of Cary's share of sales tax revenue is dependent on its population as a proportion of Wake County since sales taxes are distributed within Wake County on a per capita basis. Since Cary's population growth rate has slowed compared to the rest of Wake County, it receives a smaller portion of the total distribution amount. Had Cary's percentage distribution remained constant since its peak in FY 2001, Cary would be receiving about \$700,000 more in sales tax revenues, or 3% more, in FY 2006. Despite this smaller distribution share, the economy's signs of recovery and increases in consumer confidence are expected to yield a healthy growth of 7% in sales tax. This follows a tremendous rebound in revenue growth expected in FY 2005 over that of FY 2004 of \$2.4 million or 14%. As the Town's population growth slows in comparison to other municipalities and unincorporated areas in Wake and Chatham Counties, Cary can expect to see a correspondingly smaller share of this major source of revenue. The following graph quantifies the effects of the factors discussed above (local, state, and national) on the Town of Cary's revenue stream from FY 2001 through budgeted FY 2006.



## Utility Fund

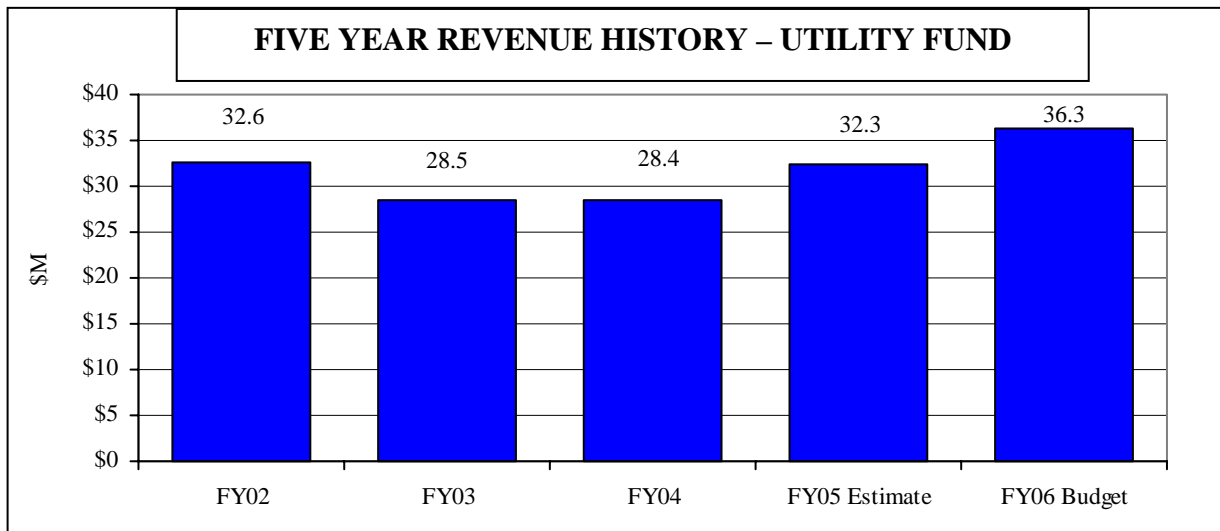
Utility Fund revenues are budgeted at \$36.3 million for FY 2006. Revenue from Water Retail Fees is expected to increase 7%, while Sewer Retail Revenue is expected to increase 23%. These increases reflect a blended rate increase of 9.1% for a residential customer using an average of 7,000 gallons per month. Consumption levels during FY 2005 thus far have been slightly higher than those of FY 2004. In order to collect enough revenue to recover the largely fixed costs of the utility system, these combined rate increases are required to generate sufficient revenue levels to pay all of the related costs. As was initiated in FY 2002, the rates in place are sufficient to generate \$1 million annually for open space acquisition. Due to revenue bond covenants entered into during Fiscal Year 2002 as a result of debt financing, the \$1 million generated during Fiscal Year 2006 will be allowed to fall into fund balance to make sure enough revenue is generated to support all operating and debt service needs. Likewise, the \$1 million generated in FY 2005 is included as an appropriation into the FY 2006 Open Space project from fund balance.

The current tiered utility rate structure shifts more of the financial burden to the high-volume users who require additional capacity to support their peak demand. The rate structure also currently includes a monthly base charge for all users. Rate changes in Fiscal Year 2002 included increasing the first tier from 4,000 to 5,000 gallons. With the Town's increased emphasis on water conservation measures, the rates provide a financial incentive for the high-volume users to conserve. As recommended in the Water Conservation and Demand Management Plan, adopted by Council in April 2000, the new tiers are designed to encourage customers to maintain their water consumption at an efficient level. The changes were adopted with implementation in March 2001, and primarily target excessive irrigation.

Other revenue sources in the Utility Fund include connection fees, pretreatment fees, water and sewer wholesale service, bulk water sales, and interest income. Total revenues in the Utility Fund are projected to increase 13% compared to the FY 2005 estimated revenues. This increase reflects slightly higher water and sewer retail revenues coupled with continued low levels of interest earnings which are indicative of lower interest rates and lower fund balance levels, especially compared to several years ago. For example, interest earnings were \$2.3 million in FY 2002 compared to less than \$1 million FY 2006. Fund balance levels are lower as well with approximately \$34 million in FY 2002 compared to about \$21 million at the end of FY 2006. Primary drivers of this reduction in Utility Fund fund balance include an \$11.2 million transfer for open space acquisition in FY 2002 and another \$13.5 million transfer to help offset utility costs related to involuntary annexation areas in FY 2003. Growing debt service needs related to infrastructure investments are continuing to increase revenue requirements in the Utility Fund. The

May 3, 2005 general obligation bond referendum of \$110 million was approved by Cary voters to help finance the Town's share of a new regional wastewater management facility.

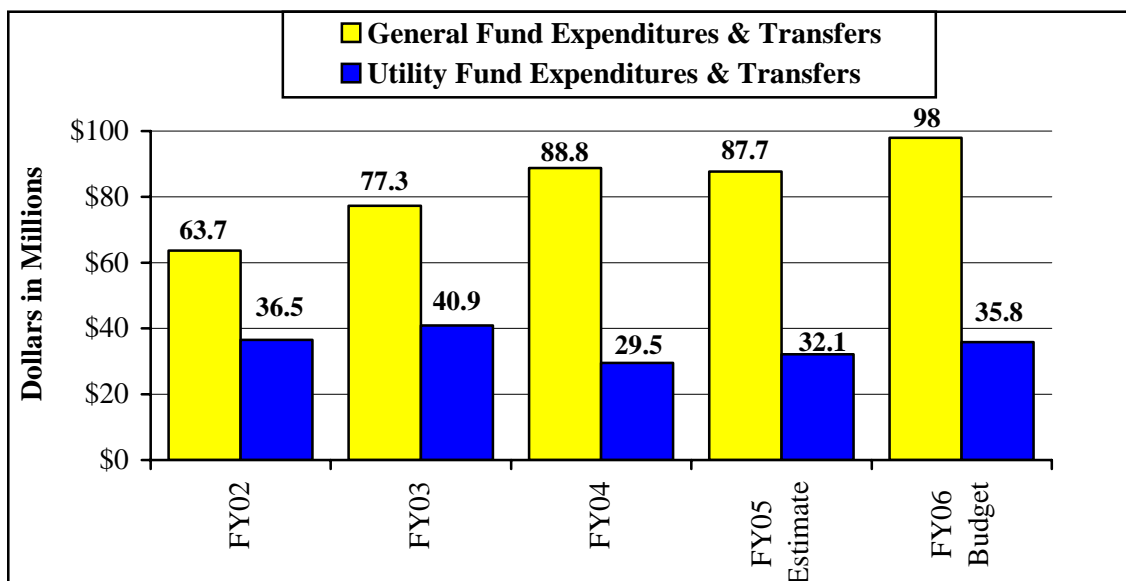
As the chart below illustrates, Utility Fund revenues have been increasing to help afford related debt service and operational cost increases.



## REVIEW OF EXPENDITURES

### General Fund and Utility Fund Total Expenditures Summary

General Fund expenditures and inter-fund transfers total \$98.0 million for FY 2006. Included in this amount is \$6.4 million in the form of fund balance transfers to support Fire, Parks, and General Capital Projects. This expenditure level reflects a \$5.4 million increase compared to FY 2005. Debt service is budgeted at \$12.2 million in FY 2006 and is expected to increase by about \$3 million more in FY 2007. Utility Fund expenses and transfers total \$35.8 million. This includes \$12.2 million to cover utility-related debt service requirements.

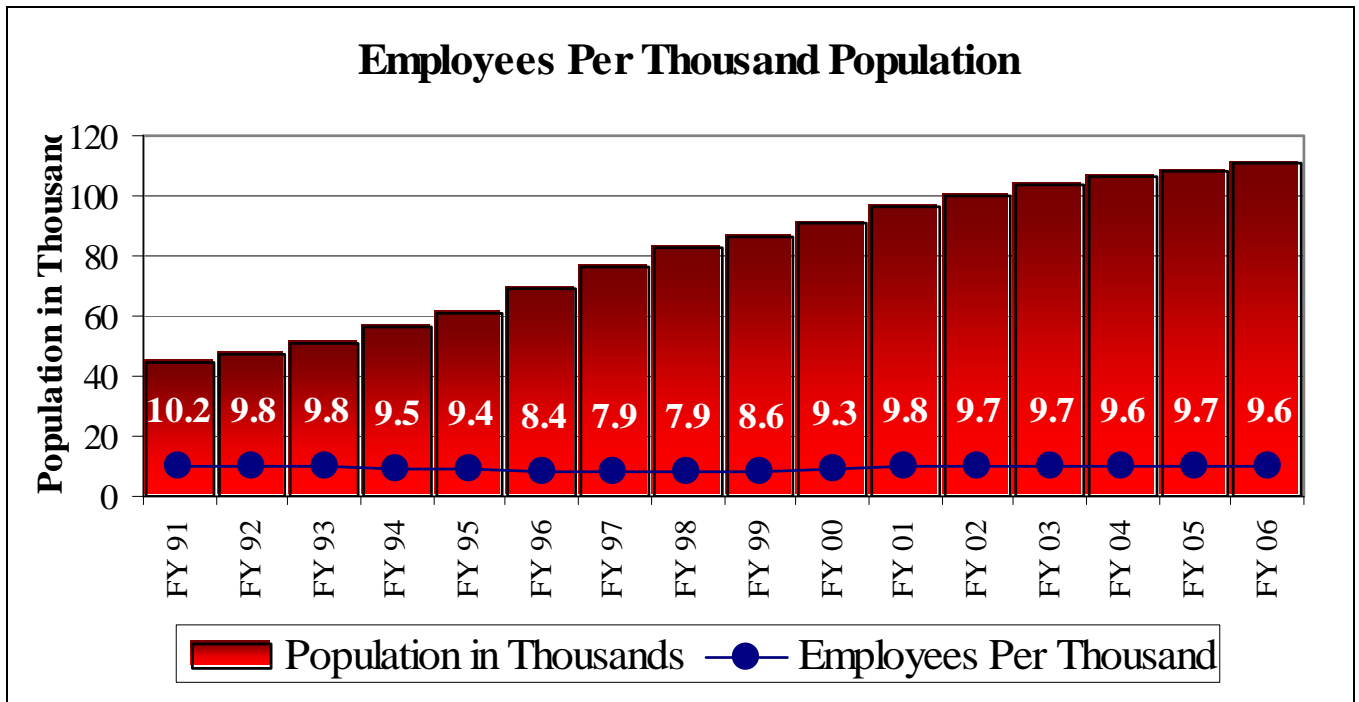


**General Fund:** Since FY 2002, debt service in the General Fund has increased by \$9M or 281%.

**Utility Fund:** FY02 includes an \$11.2M transfer to the Open Space Capital Project, and FY03 includes a \$13.5M transfer to help fund water and sewer capital requests related to Town initiated annexations effective June 30, 2003. Additionally, debt service has increased from \$7.3M in FY02 to \$12.2 M in FY06.

### Major Personnel Impacts

The demand for services has continued to grow amidst a poor economy and slower growth, so it has become increasingly difficult to maintain quality service within current funding levels. In order to maintain current essential service levels and to support upcoming capital projects coming on-line, 17.25 new positions (14.25 in the General Fund and 3 in the Utility Fund) are included in the FY 2006 Budget. The staffing ratio for FY 2006 is expected to hold fairly steady compared to the last few years at 9.7 employees per 1,000 population as portrayed in the graph below. Population figures are as of the beginning of each fiscal year and the July 1, 2005 population estimate is 109,733.



### Public Works and Utilities

Public Works and Utilities additions to staffing levels (twelve new positions during FY 2003, 23 during FY 2004, 11 during FY 2005, and 11 for FY 2006) are due to increased operating needs to maintain service levels, accommodate new programs, meet increasing regulatory requirements, and to provide for the operations and maintenance of new facilities coming on line. Examples include Middle Creek Park, Thomas Brooks Park, the Senior Center, the Koka Booth Amphitheatre at Regency Park, the Tennis Center, the Skate Park, the Thermal Biosolids Dryer, and the SAS Soccer Park and services related to Town initiated annexations such as a solid waste crew, and the fiber optic traffic signal system.

### Engineering and Operations

A Traffic Signal System Manager was added to the Engineering Department in FY 2004 and two additional positions were added in FY 2005 to help administer the new fiber optic traffic signal system project which has already begun coming on-line in FY 2005. An additional Traffic Signal System Specialist will be needed to support operations in FY 2006 as well as a Utility Engineer to help coordinate a comprehensive program to rehabilitate water and sanitary sewer lines.

### Police

Eight police officer positions were added in FY 2004 to help accommodate a reorganization of the Town's current two-district system into a three-district system. This helped facilitate improved response times as well as allowed

officers in the field to become much more familiar with their patrol areas. In FY 2005, two additional positions were added to handle increasing call volumes being experienced in the emergency communications (E-911) center and four elementary school resource officers were reassigned for to other higher priority responsibilities including two officers for the Cary and Green Hope High School ninth grade centers, one officer for increased weekend patrol, and one for increased workload in the juvenile investigations division. In FY 2006 two officers are being added to allow expansion of the IMPACT Team.

### **Fire**

Due to growth in the number of new dwellings added in the northwest part of Town over the past few years, a new fire station will be sited on Carpenter Fire Station Road just west of NC55. Construction is scheduled to begin in FY 2006. The staff will be hired in FY 2006, and both the station and new staff are expected to be in full operation by the beginning of FY 2007. Both the new third Aerial Ladder Unit and the new Fire Station will help provide service coverage necessary to maintain compliance with the Insurance Services Office's Public Fire Protection Grading Schedule (currently 3) which impacts insurance rates of all property owners within the Town.

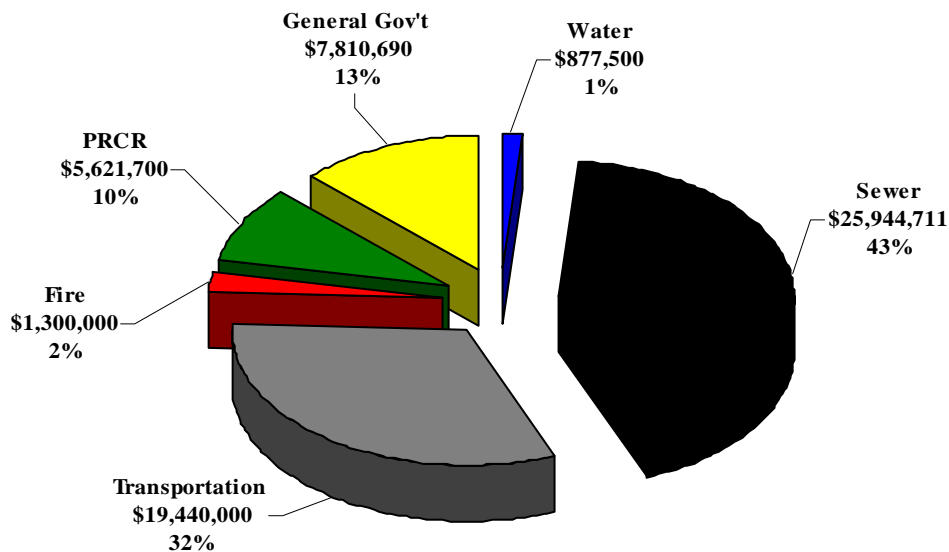
### **External Services**

As part of a continuous effort to ensure taxpayer dollars are being spent effectively and efficiently, Departments directly affected by the rate of growth in the Town conducted thorough workload reviews during FY 2003. As a result of the extreme slowdown in new development within the Town, the Inspections and Permits Department dropped two vacant positions at the beginning of FY 2003, and further reduced its workforce by 6.4 filled positions during the year. In addition, the Engineering Department reduced its workforce by 2 positions (one vacant and one filled). "No cost" reorganizations were also accomplished within both the Public Works department and the Engineering department to continue improving service levels and/or the efficiency with which services can be provided.

## **CAPITAL IMPROVEMENTS BUDGET**

The FY 2006 Capital Improvements Budget (CIB) is a separate document, but a brief summary is provided here to enhance understanding of the Town's Operating Budget. For the sixth consecutive year, the Town's Capital Improvements Program includes a ten-year plan. Prior to this, a five-year plan was used. The move to the ten-year period provides the Town of Cary with a longer planning horizon to better assess needs and to help facilitate longer-term financial planning. The CIB funds water, sewer, transportation, fire, parks, recreation and cultural resources (PRCR) and general government (Gen'l Gov't) projects. Total recommended appropriations for water and sewer projects in FY 2006 are \$26.8 million and all other general project appropriations are \$34.2 million yielding a total CIB of \$61 million.

**FY 2006 CIB PROJECT EXPENDITURES  
OF \$60,994,601  
(BY CATEGORY)**



To help support ongoing improvements in streets and park facilities, a general obligation (GO) bond referendum vote was held in February, 2003. Combined, it was the largest municipal bond referendum in North Carolina in 15 years: \$130 million for transportation needs and \$30 million for park, recreation, and cultural projects.

Another GO bond referendum in the amount of \$120 million was held and approved by voters in May 2005. This referendum focused on promoting clean water via the construction of a regional waste water management facility and the preservation of open space. \$110 million of the \$120 million in bond authority approved by voters in May 2005 is in support of Cary's share of the design and construction of the Western Wake Regional Wastewater Management Facility (WWRWMF), while the remaining \$10 million is to be directed toward the acquisition of open space.

General obligation debt is one of the least expensive forms of municipal borrowing and was approved by the voters in both referendums following a series of public input sessions and presentations to various civic groups. General obligation bond approved authority is available for use for seven years, and if possible given various project priorities, being able to spread the use of this borrowing capacity over that time frame will help stabilize debt service to some degree and ensure the highest priority projects are selected each year.

The FY 2006 Proposed Budget recommends appropriating a total of \$19.6 million of the 2003 GO Bond authority in support of transportation and parks, recreation and cultural projects. \$15.3 million of this appropriation would support Transportation projects, while \$4.3 million would be directed toward PRCR projects in FY 2006.

In the General CIB, a transfer of \$6.4 million from General Fund fund balance supplements other revenues dedicated to capital projects. A \$1,000,000 transfer will be made from the Utility Fund retained earnings in FY 2006 to support the Open Space Acquisition project within the Utility CIB. Water rates were raised 3% in FY 2002 to generate this ongoing source of funding.

In addition to transfers, major revenues in the General and Utility Capital Improvements Budgets include Powell Bill revenues (for qualified Transportation projects), vehicle license fees, interest on investments, reimbursements, contributions, debt funding for various utility projects, water and sewer development fees, and restricted capital reserve fund balances.

General Obligation debt is also recommended as the funding source for \$12.9 million in FY 2006 project needs associated with Cary's portion of the Western Wake Regional Wastewater Management Facility. This recommendation marks the first appropriation of funds from the \$110 million of GO authority approved by voters in May 2005 for the WWRWMF.

The FY 2006 Proposed Utility CIB also relies on \$2.3 million in Utility Capital Reserve Fund Balance and \$3 million in new revenue bond debt to address other water and sewer capital project needs identified for FY 2006.

Council directed staff at the 2005 Council/Staff Retreat to begin the capital planning process earlier during the budget process this year. This recommended capital budget reflects those projects that formed the basis for discussion during the first capital worksession which took place in April. All changes and adjustments from those worksessions and through the remainder of the budget process will be incorporated into the final budget for adoption by the full Council.

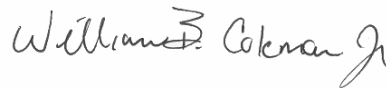
Planning for major capital projects and the increased operational costs that often accompany them will remain critical. With so many potential projects, and recent revenue trends indicating only slight growth in income, the Town of Cary will continue to be forced to make difficult choices in the near future. Future funding for critical road needs must be addressed along with other crucial infrastructure priorities such as parks, fire stations, water tanks and water and sewer lines. The Town must continue to ensure that funding is in place to allow adequate infrastructure to maintain the quality of life for existing citizens, as well as for the future citizens of Cary. In looking to the Town's future needs, all financing options must be thoroughly investigated to ensure that infrastructure requirements are met in a manner that maximizes resources, allows flexibility in funding decisions and maintains a strong financial position.

## **SUMMARY**

The FY 2006 Budget is balanced in accordance with state statutes and addresses the goals and priorities established by Town Council for the Town's future. The budget is fiscally sound, and although it does not fund all initial requests made by departments, it does address top priority needs and enhances service levels where needed. The long-term capital plan is indeed a plan, which will need to be adjusted according to changes in needs for projects and the availability of funding for capital investments.

I wish to recognize and extend thanks to staff in all Town departments for their invaluable assistance during the budget process and express my appreciation to the Town staff who helped in preparing this budget.

Respectfully submitted,



William B. Coleman, Jr.  
Town Manager