

CITY OF ASHEVILLE
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2007

As management of the City of Asheville (The City), we offer readers of the City of Asheville's financial statements this narrative overview and analysis of the financial activities of the City of Asheville for the fiscal year ended 2007. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in the City's Notes to the Financial Statements, which follow this narrative.

FINANCIAL HIGHLIGHTS

- The assets of the City of Asheville exceeded its liabilities at the close of the most recent fiscal year by \$357,500,228 (*net assets*). Of this amount, \$84,293,937 (*unrestricted net assets*) may be used to meet the government's ongoing obligations to citizens and creditors.
- The City's total net assets increased by \$22,356,554.
- As of the close of the current fiscal year, the City of Asheville's governmental funds reported combined ending fund balances of \$51,253,328 an increase of \$2,929,163 in comparison with the prior year. Approximately 27% or \$13,930,710 is the undesignated portion of the general fund, therefore available to spend at the government's discretion.
- At the end of the current fiscal year, reserved fund balance for governmental funds was \$25,224,321, while unreserved totaled \$26,029,007 or 51% of total governmental fund expenditures.
- The City's total long-term liabilities decreased by approximately \$7.5 million during the current fiscal year. This net decrease is attributable to the normal pay down of existing debt.
- The City holds the following bond ratings:

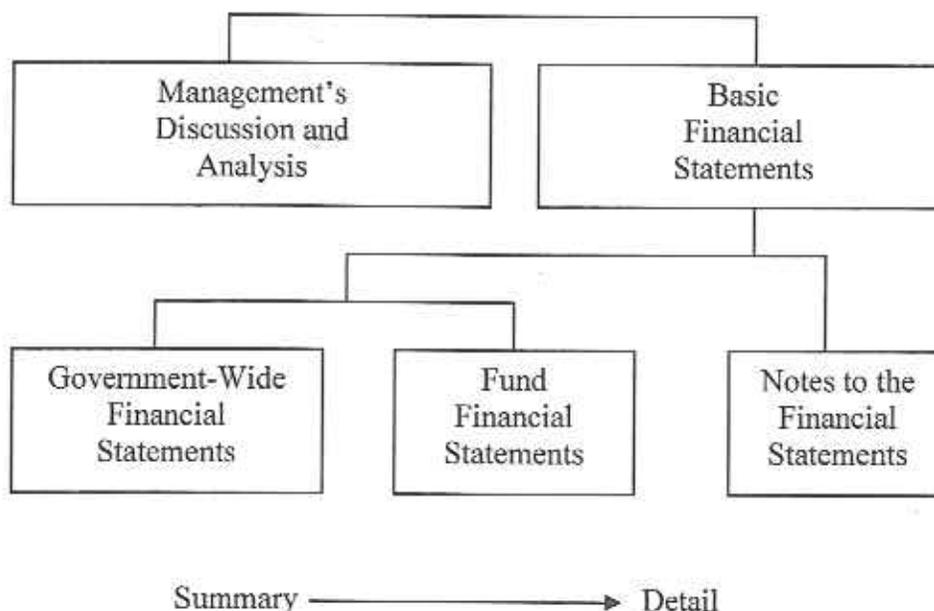
Moody's	Aa2
Standard & Poor's	AA

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the City of Asheville's basic financial statements. The financial statements include two kinds of statements that present different views of the City: 1) Government-Wide Financial Statements and 2) Fund Financial Statements. Both perspectives, however, are essential and complementary components that allow the user to address relevant questions, broaden a basis for comparison, and enhance the City's accountability. Another element of the basic financial statements is the notes to the financial statements. In addition to the basic financial statements, the report contains other supplemental information that will enhance the reader's understanding of the financial condition of the City of Asheville as well as compliance issues that are addressed by Government Auditing Standards, Office of Management and Budget (OMB) Circular A-133 and the North Carolina Single Audit Implementation Act.

CITY OF ASHEVILLE
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2007

Required Components of Annual Financial Report



Basic Financial Statements

The first two statements (Exhibits A and B) in the basic financial statements are the **Government-wide Financial Statements**. They provide a broad overview of the City's financial position and operations, in a manner similar to a private-sector business. The *statement of net assets* presents the City's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City is improving. The *statement of activities* presents information on how the city's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of related cash flows. Therefore, revenues and expenses are reported in this statement, which result in cash flows in future fiscal periods, such as uncollected taxes and earned but unused vacation leave.

Government-wide statements are divided into governmental and business-type activities. The governmental activities include most of the City's basic services such as public safety, recreation, transportation, community and economic development, and general government. Property taxes, intergovernmental revenues, and other local taxes finance about 71% of the costs of these activities. Business-type activities include water utility, stormwater management, parking, festivals, golf course, civic center, and mass transit services. These activities are primarily paid from charges to customers excluding transit which receives federal grants and transfers from general fund as its primary source of funding.

CITY OF ASHEVILLE
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2007

The **Fund Financial Statements** (Exhibits C through J) provide a more detailed look at the City's most significant activities. A fund is used to maintain control over resources that have been segregated for specific activities or objectives. Fund accounting ensures and reflects compliance, or non-compliance, with related legal requirements, such as General Statutes, grantor provisions, or the City's budget ordinance. The funds of the City are divided into three categories: 1) the governmental fund statements, 2) the proprietary fund statements, and 3) the fiduciary fund statement.

Governmental Funds. Governmental funds are used to account for most basic services and are reported as governmental activities in the government-wide financial statements. Governmental funds are reported using an accounting method called modified accrual accounting, which provides a short-term spending focus. The relationship between government activities (reported in the Statement of Net Assets and the Statement of Activities) and governmental funds is described in a reconciliation that is a part of the fund financial statements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the entity-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet (Exhibit C) and the governmental fund statement of revenues, expenditures, and changes in fund balances (Exhibit D) provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*. (Exhibit C & E)

The City of Asheville maintains eleven individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the General Fund. Data from the other ten governmental funds are combined into a single, aggregated presentation. Individual fund data for each of these non-major governmental funds is provided in the form of *combining statements* elsewhere in this report.

The City of Asheville adopts an annual appropriated budget for its General Fund as required by General Statute. A budgetary comparison statement has been provided for the General Fund to demonstrate compliance with this budget. (Exhibit F)

Proprietary Funds. The City of Asheville maintains two types of proprietary funds. *Enterprise funds* are used to report the same functions presented as *business-type activities* in the entity-wide financial statements. The City of Asheville uses enterprise funds to account for its Water Resources, Civic Center, Festivals, Parking Services, Golf Course, Stormwater Management, and Mass Transit Operations.

The City has one internal service fund to account for its self-insurance program. The fund is not yet fully operational as the City was not able to change its budgeting and accounting system to allocate its charges and claims. Because these services will predominantly benefit governmental rather than

CITY OF ASHEVILLE
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2007

business-type functions, they have been included in the governmental-type activities in the government-wide statements.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The proprietary fund financial statements provide separate information for the Water Resources Fund, which is considered to be a major fund of the City of Asheville. The basic proprietary fund financial statements can be found in Exhibit G through I of this report.

Fiduciary Funds: Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are *not* reflected in the government-wide financial statement because the resources of those funds are *not* available to support the City of Asheville's own programs. The accounting used for fiduciary funds is much like that used for proprietary funds. The City of Asheville maintains one agency fund, which is its only fiduciary fund. The basic fiduciary fund financial statement can be found on Exhibit J of this report.

Notes to the Basic Financial Statements: The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements are on pages 28-57 of this report.

Other Information: In addition to the basic financial statements and accompanying notes, this report also presents certain *required supplementary information* concerning the City of Asheville's progress in funding its obligation to provide pension benefits to its employees. Required supplementary information can be found on pages 58-59 of this report. The combining statements referred to earlier in connection with non-major governmental funds are presented immediately following the required supplementary information on pensions. The other supplemental information shows details about the City's individual funds, including budgetary information required by the North Carolina General Statutes, as well as other data that the City considers helpful to the reader.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

The Government-wide financial statements are designed to provide the reader with a broad overview of the City's finances, similar in format to a financial statement of a private-sector business. The government-wide statements provide short and long-term information about the City's financial status as a whole. The two government-wide statements report the City's net assets and how they have changed. Net assets are the difference between the City's total assets and total liabilities. Measuring net assets is one way to gauge the City's financial condition.

As noted earlier, net assets may serve over time as a useful indicator of a government's financial condition. In the case of the City of Asheville, assets exceeded liabilities by \$357,500,228 as of June 30, 2007.

By far the largest portion of the City's net assets (\$265,934,201 or 74.0%) reflects the City's investment in capital assets (e.g., land, buildings, infrastructure, machinery, and equipment), less any related debt that is still outstanding that was issued to acquire those assets. The City of Asheville uses these capital assets to provide services to citizens; consequently, these assets are *not* available for future spending. Although the City of Asheville's investment in its capital assets is reported net

CITY OF ASHEVILLE
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2007

of the outstanding related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets are committed to the continued provision of service and cannot be used to liquidate these liabilities. Restricted net assets, 2.0% of the City's net assets, represent resources that are subject to external restrictions. These restrictions consist of employee paid health benefits as well as reservations for capital projects. In addition, total unrestricted net assets amounted to 24% of total net assets. Unrestricted net assets may be used to meet the government's ongoing obligation to citizens and creditors.

Net Assets of the City of Asheville						
	Governmental Activities		Business-type Activities		Total	
	2006	2007	2006	2007	2006	2007
Current and						
Other Assets	\$ 59,590,491	\$ 64,083,327	\$ 37,121,233	\$ 47,377,422	\$ 96,711,724	\$ 111,460,749
Capital Assets	196,889,755	190,387,389	143,701,439	147,285,267	340,591,194	337,672,656
Total Assets	<u>256,480,246</u>	<u>254,470,716</u>	<u>180,822,672</u>	<u>194,662,689</u>	<u>437,302,918</u>	<u>449,133,405</u>
Non-current Liabilities	36,585,374	32,265,355	49,681,550	50,065,508	86,266,924	82,330,863
Other Liabilities	7,101,440	3,584,187	8,790,880	5,718,127	15,892,320	9,302,314
Total Liabilities	<u>43,686,814</u>	<u>35,849,542</u>	<u>58,472,430</u>	<u>55,783,635</u>	<u>102,159,244</u>	<u>91,633,177</u>
Net Assets:						
Invested in Capital						
Assets, Net of						
Related Debt	173,598,743	166,595,239	92,518,623	99,338,962	266,117,366	265,934,201
Restricted	12,076,630	7,272,090	-	-	12,076,630	7,272,090
Unrestricted	27,118,059	44,753,845	29,831,619	39,540,092	56,949,678	84,293,937
Total Net Assets	<u>\$ 212,793,432</u>	<u>\$ 218,621,174</u>	<u>\$ 122,350,242</u>	<u>\$138,879,054</u>	<u>\$ 335,143,674</u>	<u>\$ 357,500,228</u>

As indicated above, assets of the City exceeded liabilities by \$357,500,228 at June 30, 2007. Analysis of the business-type activities indicates that the capital assets increased \$3.5 million in fiscal year 2007. The increase is a result of several capital water system improvements.

Governmental activities. Net assets of governmental activities increased by \$5,827,742. Key elements of this increase are as follows:

- Property tax revenues increased by \$4.3 million or 11.8% during the year. This is attributable to growth within the city due to increased construction activity and a slight adjustment in the property tax rate following the most recent revaluation.
- Strong economic growth for the year led to an increase in sales tax revenue of \$1.2 million.
- Special Items decreased \$2.0 million during the year. In Fiscal 2006 the City acquired the assets of the Nature Center and McCormick Field baseball stadium with the dissolution of the water agreement with the County. This caused the City's capital assets as well as overall net assets to increase. These amounts are reported as special items as discussed in the notes. In addition, in Fiscal 2007 the Certificate of Participation for the Asheville Claims Corporation

**CITY OF ASHEVILLE
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2007**

matured and was recorded as a special item in the newly created internal service fund. This added \$5.0 million in revenue (classified as a special item) at June 30, 2007.

Changes in Net Assets of the City of Asheville						
	Governmental Activities		Business-type Activities		Total	
	2006	2007	2006	2007	2006	2007
Revenues:						
Program revenues:						
Charges for services	\$ 15,163,538	\$ 15,653,381	\$ 32,882,022	\$ 40,656,903	\$ 48,045,560	\$ 56,310,284
Op. grants & contributions	6,645,765	6,577,739	2,171,052	2,373,935	8,816,817	8,951,674
Cap. grants & contributions	2,897,150	2,374,032	4,137,452	3,570,539	7,034,602	5,944,571
General revenues:						
Property taxes	36,913,609	41,254,144	-	-	36,913,609	41,254,144
Other taxes	22,192,656	23,562,645	-	-	22,192,656	23,562,645
Grants & contributions not restr'd to spec programs	1,059,358	1,512,902	-	-	1,059,358	1,512,902
Inv earnings & misc	2,724,292	3,127,186	541,966	1,170,876	3,266,258	4,298,062
Gain (loss) on capital assets	125,982	(89,351)	16,852	51,175	142,834	(38,176)
Special items	7,189,066	5,044,004	7,004,300	-	14,193,366	5,044,004
Total Revenues	\$ 94,911,416	\$ 99,016,682	\$ 46,753,644	\$ 47,823,428	\$ 141,665,060	\$ 146,840,110
Expenses:						
General government	16,032,815	18,248,574	-	-	16,032,815	18,248,574
Public Safety	33,384,277	34,453,963	-	-	33,384,277	34,453,963
Highway/streets	20,076,196	21,238,852	-	-	20,076,196	21,238,852
Econ Development	4,784,757	5,920,353	-	-	4,784,757	5,920,353
Culture and recreation	7,782,635	9,767,235	-	-	7,782,635	9,767,235
Int on long-term debt	1,179,077	1,243,027	-	-	1,179,077	1,243,027
Water Resources	-	-	20,194,049	20,616,840	20,194,049	20,616,840
Civic Center	-	-	2,251,998	2,220,029	2,251,998	2,220,029
Festivals	-	-	1,269,793	1,314,846	1,269,793	1,314,846
Parking Services	-	-	1,249,256	1,330,059	1,249,256	1,330,059
Mass Transit	-	-	4,262,696	4,633,166	4,262,696	4,633,166
Stormwater	-	-	1,994,752	2,500,297	1,994,752	2,500,297
Golf Course	-	-	884,124	996,314	884,124	996,314
Total Expenses	\$ 83,239,757	\$ 90,872,004	\$ 32,106,668	\$ 33,611,551	\$ 115,346,425	\$ 124,483,555
Increase in net assets						
before transfers	11,671,659	8,144,678	14,646,976	14,211,877	26,318,635	22,356,555
Transfers	(1,942,940)	(2,316,936)	1,942,940	2,316,936	-	-
Increase in net assets	9,728,719	5,827,742	16,589,916	16,528,813	26,318,635	22,356,555
Net assets, beginning of year	203,064,713	212,793,432	105,760,325	122,350,241	308,825,039	335,143,673
Net assets, end of year	\$ 212,793,432	\$ 218,621,174	\$ 122,350,241	\$ 138,879,054	\$ 335,143,674	\$ 357,500,228

CITY OF ASHEVILLE
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2007

For the most part, increases in expenses closely parallel inflation and growth in the demand for services. In Fiscal 2007 the City adopted The Market Based Compensation Plan. This caused an increase in salaries across the City. Police, Fire and Engineering as well as some of the lowest paying jobs in the City were implemented in the first year. General government expenses increased by 13.9% for the fiscal year primarily due to increases in health care expenses.

Public Safety expenses increased by 3.2% due to the addition of eighteen new firefighters in January 2007 to staff the two new fire stations that opened in July 2007.

Culture and recreation increased \$2.0 million in the year. This increase is due a larger percentage of their budget being used in the current year on operations as compared to prior year where a larger portion of the budget was spent on capital projects or improvements that are not expensed on the government-wide statements.

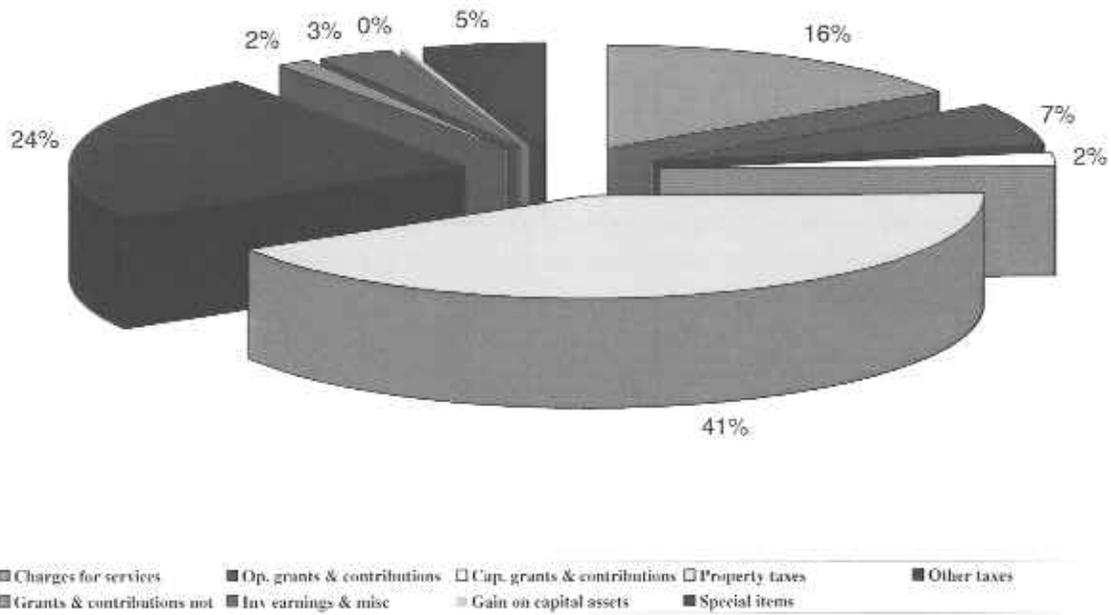
Highways/streets increased 5.8% as compared to last year due to the increase in material costs such as concrete and asphalt.

Other general government activities regarding housing initiatives include:

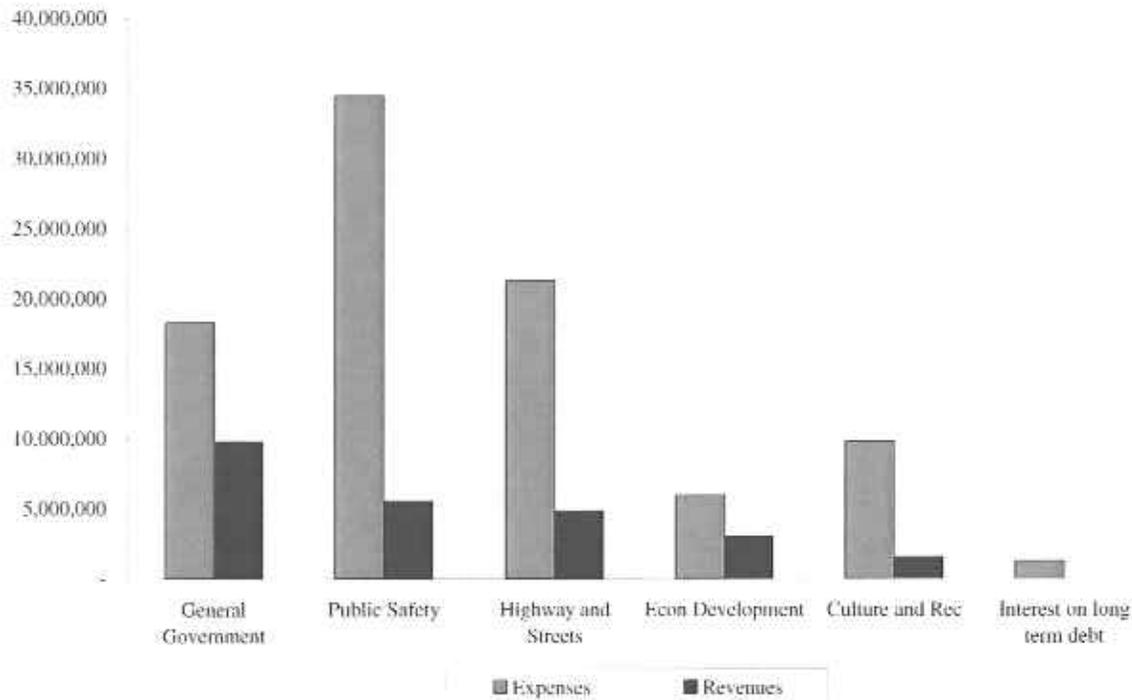
- Housing Trust Fund: 139 new homes or housing units, assisted with Housing Trust Fund loans, were completed in FY 2007. This includes the completion of one apartment complex and 70 out of 123 units in another apartment complex being renovated and reoccupied.
- CDBG and HOME funds assisted the production of 419 affordable housing units by the City and non-profit partners. CDBG funds were also used to assist over 5,000 people with needed services, including 111 homeless people, 36 who moved out of homelessness into permanent housing, and to start or expand 46 small businesses.
- CDBG and HOME funds assisted in upgrading the transit system by adding bus shelters, benches, and route signs.

**CITY OF ASHEVILLE
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2007**

Revenues by Source - Governmental Activities



Expenses and Program Revenue - Governmental Activities

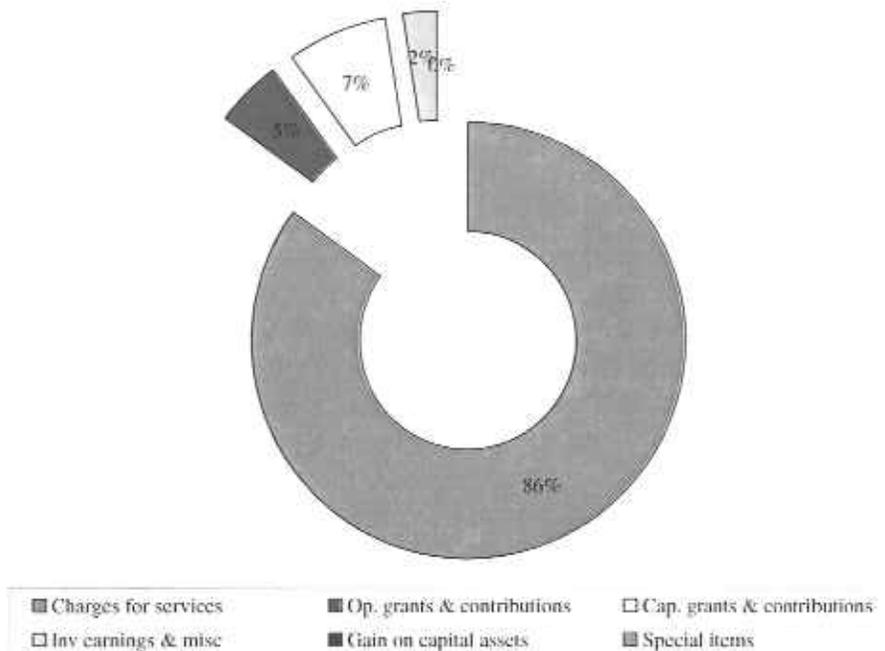


**CITY OF ASHEVILLE
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2007**

Business-type activities. Business-type activities increased the City of Asheville's net assets by approximately \$16.5 million for FY 2007. Key elements of this increase are as follows:

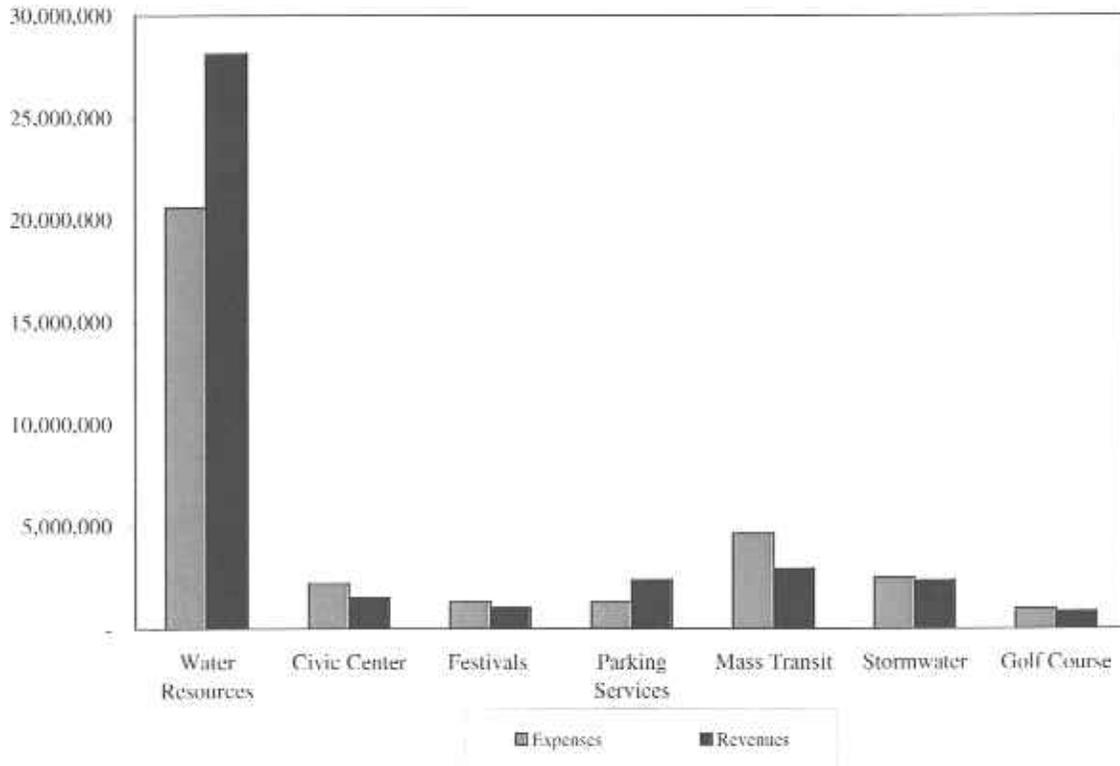
- Additional revenue of \$6.1 million resulted from the adoption of a new Water Capital Improvement Fee in the current year. This fee is to fund major capital improvements such as water main replacement and water treatment source improvements.
- Non-major enterprise funds had a combined increase in revenue of \$1.3 million attributable mainly to the Stormwater fund. Improvements to the billing system for Stormwater in the second year of operations caused the increase.
- Transit expenses increased approximately 8.3% due to increased fuel costs; however, \$414,268 additional grant revenue dollars countered the increased cost of operations.

Revenues by Source - Business Type Activities



**CITY OF ASHEVILLE
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2007**

Expenses and Program Revenues - Business Type Activities



Capital Asset and Debt Administration

Capital assets. The City's investment in capital assets for the governmental and business-type activities as of June 30, 2007, totals \$337,672,656 (net of accumulated depreciation). These assets include land, buildings, improvements other than buildings (infrastructure assets, such as streets, sidewalks, and water lines), machinery and equipment, and construction in progress. Summary of major capital projects for the year include a new fire station in the West Asheville area, replacement of 3 fire engines, replacement of vehicles within public works, water and the police departments, and upgrading the City's telephone system and radio system infrastructure. (See *Note 4* for additional information)

CITY OF ASHEVILLE
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2007

Capital Assets of the City of Asheville

	Governmental		Business-type		Total	
	Activities		Activities			
	2006	2007	2006	2007	2006	2007
Land	\$ 27,321,138	\$ 27,335,953	\$ 10,271,758	\$ 10,271,758	\$ 37,592,896	\$ 37,607,711
Buildings & Improvements	45,098,905	45,379,341	80,560,800	80,604,532	125,659,705	125,983,873
Machinery & Equipment	28,420,969	31,075,038	14,432,930	16,576,270	42,853,899	47,651,308
Infrastructure	204,736,311	204,948,506	109,208,525	112,545,959	313,944,836	317,494,465
Construction In Process	12,266,712	14,906,457	4,559,708	7,787,702	16,826,420	22,694,159
Accumulated Depreciation	(120,954,280)	(133,257,906)	(75,332,282)	(80,500,954)	(196,286,562)	(213,758,860)
Total	\$ 196,889,755	\$ 190,387,389	\$ 143,701,439	\$ 147,285,267	\$ 340,591,194	\$ 337,672,656

Long-term Debt. The City of Asheville's total general obligation and revenue bonds debt decreased by \$4,110,000 (7.6%) during the current fiscal year in accordance with its regularly scheduled maturity dates. The City did not issue any new debt in the current year.

The City of Asheville maintains an "AA" rating from Standard & Poor's and an "Aa2" rating from Moody's for general obligation debt. This bond rating is a clear indication of the sound financial condition of the City.

State statutes limit the amount of general obligation debt a governmental entity may issue to 8% of its total assessed value of taxable property located within that government's boundaries. The legal debt margin for the City of Asheville is \$770,135,787, which is significantly in excess of the City's outstanding general obligation debt. Additional information regarding the City of Asheville's long-term debt can be found in Note 7 of this report.

Outstanding Debt—General Obligation and Revenue Bonds

	Governmental Activities		Business-type Activities		Total	
	2006	2007	2006	2007	2006	2007
General Obligation Bonds	\$ 6,057,187	\$ 4,455,696	\$ 6,412,813	\$ 5,124,304	\$ 12,470,000	\$ 9,580,000
Revenue Bonds	-	-	41,800,000	40,580,000	41,800,000	40,580,000
Total	\$ 6,057,187	\$ 4,455,696	\$ 48,212,813	\$ 45,704,304	\$ 54,270,000	\$ 50,160,000

CITY OF ASHEVILLE
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2007

General Fund Budgetary Highlights

- The unemployment rate for Buncombe County is currently 4.0%, up from a rate of 3.6% one year ago. This compares favorably to the state's average unemployment rate of 5.1%.
- Population of 75,947 has grown 9.7% from 2000 to 2006.
- Inflationary trends in the region compare favorably to national indices.

All of these factors were considered in preparing the City of Asheville's budget for the 2008 fiscal year.

During the current fiscal year, unreserved fund balance in the general fund increased to \$21,873,433. The City of Asheville has appropriated \$4,421,019 of this amount to balance the FY 2007-08 budget.

Budget Highlights for the Fiscal Year Ending June 30, 2008.

The City's adopted General Fund budget for FY 2008 totaled \$89,228,929, which represents a 9.7% increase over the FY 2007 budget. The FY 2008 budget includes \$450,000 to fund the second year implementation of the market-based compensation plan. Police and Fire expenditures continue to be the largest component of the City's General Fund budget comprising 37% of the total FY 2008 General Fund budget. The budget includes \$475,000 to enhance police services by adding two additional beats, increasing staffing at the telecommunications center and in forensics, and adding 3 detective positions. \$79,000 is budgeted to bolster fire services in two rural areas of the city, while \$130,000 is included to fund a new firefighter retirement benefit. Approximately \$460,000 is included to provide a full-year's funding for 23 positions that were only funded for a partial year in FY 2007. Of these positions, 18 are firefighter positions for the two new fire stations that opened in July 2007. The General Fund budget also includes \$9.7 million in pay-as-you-go capital improvement funding. This funding will allow the City to continue replacing its aging fleet of vehicles and undertake several other high priority projects, including the Hominy Creek and French Broad River greenway projects, traffic & pedestrian improvements, the completion of the E. Oakview Bridge project, and the I-40 noise wall enhancement. The fiscal year 2008 General Fund budget includes \$6.21 in debt service for the City's general obligation bonds, certificates of participation (COPs), and other general debt obligations, which is a decrease compared to the prior year. The City will issue new general fund debt in FY 2008 to fund the replacement of various large pieces of equipment in fire and public works, and the upgrade of the City's enterprise software system.

Business-type Activities. The FY 2008 budget for the Water Resources Fund includes \$6.0 million from the capital maintenance fee, which was implemented in FY 2007. The purpose of this fee is to provide funding for major capital improvements such as water line replacements and water treatment source improvements. With this fee, the total capital budget for FY 2008 is \$7.5 million. This total

CITY OF ASHEVILLE
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2007

includes funding for the Fairview Reservoir, the Clingman Avenue project, the NCDOT Long Shoals I26-US25 project, rolling stock, and small capital equipment. Aside from the capital improvement fee, the Water budget maintains current rates, and it is assumed that there will be no growth in demand. Operating expenses will be reduced or held constant wherever possible. Water Resources' debt service for FY 2008, which is 17% of the total budget, includes debt service for the 1992 General Obligation Bonds, the 1996 NC Water Quality Loan, Series 1996 Revenue Bonds, and Series 2001 Revenue Bonds.

During fiscal 2007, there was a \$5,164,465 increase in appropriations between the original and final amended budget of expenditures. Some of the components of that increase were:

- \$2.5 million appropriated to the capital reserve fund for high priority capital projects;
- \$593,987 appropriated for reserve for encumbrances;
- \$132,996 appropriated for additional development review staff to be funded with state utility tax revenue;
- \$115,428 appropriated to the Transit department for fare box changes and to continue evening service;
- \$183,590 in reimbursement revenue from FEMA appropriated for Azalea Park damage;
- \$694,000 in stop-loss insurance recovery revenue appropriated to cover health care expenditures;
- \$250,000 appropriated from fund balance to purchase land at the airport;
- \$325,000 appropriated from fund balance to fund the lease purchase agreement for Beaucatcher Mountain property.

Ad valorem taxes exceeded budget expectations because revaluation appeals were lower than expected and the assessed valuation of real property increased by 5.5% rather than the estimated 3.5%. Local option sales tax revenue increased by 10.69% in fiscal year 2007 and exceeded budget by \$1.5 million. Investment earnings exceeded budgetary expectations due to the increase in interest rates, a shorter reimbursement philosophy and more available cash for investments. The other major General Fund revenue categories – intergovernmental and charges for services – also exceeded budget estimates.

Requests for information

This financial report is designed to provide a general overview of the City of Asheville's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Office of the Chief Financial Officer, City of Asheville, PO Box 7148, Asheville NC 28802.

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