

August 30, 2005

To the Citizens of the Village of Vernon Hills:

The comprehensive annual financial report of the Village of Vernon Hills for the fiscal year ended April 30, 2005, is hereby submitted. Responsibility for both the accuracy of the data, and the completeness and fairness of presentation, including all disclosures, rests with the Village. To the best of our knowledge and belief, the enclosed data are accurate in all material respects and are reported in a manner designed to present fairly the financial position and results of operations of the various funds and account groups of the government. All disclosures necessary to enable the reader to gain an understanding of the Village's financial activities have been included.

The Comprehensive annual Financial Report is presented in three sections: introduction, financial and statistical. The introduction section includes the transmittal letter, the Village's organizational chart, the Village's list of principal officers and a reproduction of the Village's Certificate of Achievement for Excellence in Financial Achievement, which was awarded for last years' report. The financial section includes management's discussion and analysis, government-wide financial statements, notes to the financial statement, required and other supplementary information, as well as the independent auditor's report on the financial statements and schedules. The statistical section lists selected financial and demographic information, generally presented on a multi-year basis. This letter is should be read in conjunction with the management discussion and analysis. Because this letter allows for more subjectivity than the management discussion and analysis, it is the appropriate vehicle for discussing the Village's goals, plans, processes and underlying assumptions. Accordingly, the transmittal letter serves an important role in explaining the Village's finances.

This report includes all funds and account groups of the Village. The Village provides a diverse but limited array of services. Its major functions are police services; construction and maintenance of Village streets and related infrastructure; building review and inspection; development review; and general administrative services. The Village operates a cable studio. The Village also provides a nine-hole golf course. It also owns the Vernon Hills Athletic Complex and operates it in conjunction with the Vernon Hills Parks District. The Park District provides other recreational services.

Complimentary recreational services are provided by the Lake County Forest Preserve, which provides forested scenic areas, and bike trails adjacent to the Village limits. Water and sewer services are provided by Lake County. Fire protection is provided by Countryside Fire Protection District and the Lincolnshire - Riverwoods Fire Protection District. The Village is served by two library districts, two townships, four grade school districts, and three high school districts. The Vernon Hills Park District, the fire protection districts, library districts, townships, school districts and Lake County governments have not met the established criteria for inclusion in the reporting entity, and accordingly, are excluded from this report.

ECONOMIC CONDITION AND OUTLOOK

Vernon Hills is located in central Lake County about 35 miles north of downtown Chicago. Vernon Hills has easy access to the Chicago - Milwaukee Tollway, and accordingly, easy access to Chicago's O'Hare Airport as well as Milwaukee's Mitchell Airport. Vernon Hills is a growing area in the Chicago metropolitan area, and is a major employment center. It is also a major center of retail shopping in Lake County.

The Village's retail base includes the Westfield Hawthorn Center, with 1.4 million square feet of leasable retail space anchored by Sears Roebuck & Co., Carson Pirie Scott & Co., J.C. Penny and Marshall Fields. Westfield is currently submitting plans to the Village for a 250,000 to 400,000 square foot expansion combined with a multiplex theatre and a parking garage. The 240 thousand square foot Hawthorn Fashion Square was completed in 1987 and is anchored by Linens & Things, and Wickes Furniture. The 320 thousand-foot Rivertree Mall was completed in 1988 and includes Best Buy, Office Depot, PetsMart and T.J. Maxx. The Townline Commons was completed in 1990 and is anchored by Walmart, Toys R Us and Plunketts. It also has a freestanding Jared's Jewelers. In 1992 a freestanding 45 thousand square foot Sportmart was opened; it recently became a Sports Authority. In 1993, a 131 thousand square foot Target Greatland opened; a 40 thousand square foot expansion is currently under construction at Target. The Marketplace Shopping Center, opened in 1994, is currently anchored by a Home Depot, a Circuit City and a 110 thousand square foot Home Expo which opened in 2001. There has been a vacancy in Marketplace since 2001, when Super K-Mart closed, but a redeveloped was completed in early 2005 which includes a Bed Bath and Beyond, an Old Navy, a Ashley Furniture, a Joanne's Fabrics and a DSW (Discount Shoe Warehouse). A freestanding Sam's Club opened in 2001. In July of 1997, the mail order, warehouse and corporate facility for CDW opened. The original facility was 224 thousand square feet and cost \$10.6 million. CDW has subsequently become a Fortune 1000 Company and completed a \$5 million expansion including a child care facility and an employee fitness center. In calendar year 2000, CDW opened a new facility in Vernon Hills containing over 200 thousand square feet. CDW is currently planning to lease a 140 thousand square foot building from Allstate. The Village has an economic development agreement with CDW in effect to July 31, 2019 involving the rebating of sales tax. It has a maximum rebate level of 50%, which is applicable as long as the Village collects at least \$2 million annually in sales tax from CDW. If sales tax receipts fall between \$650,000 and \$2 million, the rebate is 35%. Between \$500,000 and \$650,000, the rebate is 20% and below \$500,000 there is no rebate.

The Village has a number of neighborhood shopping centers, including Hawthorn Village Commons, Vernon Plaza, White Hen Plaza, and Evergreen Plaza. These malls include Dominick's, 7 -11, White Hen Pantry, and Walgreen's Drug Store. The Village also has a number of freestanding restaurants that are independent or part of national and local chains. Two multi-screen movie theatres and a comedy club contribute to the Village's amusement tax base.

In FY2004-05, sales tax was down by 1.1% from FY2003-2004. This slight decline is partly due to some restructuring at CDW that took some of the company's sales associates out of the Village. These adjustments have been completed and, based on discussions with CDW; Village anticipates future stability in this segment of its sales tax.

Prior to 1986, few office buildings were located in the Village, the most significant of which being the Rustoleum's international headquarters. In 1986, Van Vilssingen and Company began development in the Village of a 320-acre office and light-manufacturing park known as Corporate Woods. According to *Crains*, Corporate Woods is the 15th largest industrial park in the Chicago region.. Among the largest buildings in Corporate Woods are the 130 thousand square foot Richard Wolf Medical Instrument Corporation building, 235 thousand square foot Mitsubishi building, the 161 thousand square foot Z.F. Industries building, and the Zebra Technologies building, which has been expanded to 122 thousand square feet. In 1988, Prentiss / Copley began development of the 600 acre office park known as Continental Executive Parke. It includes the 140 thousand square foot Allstate building, 260 thousand square foot Cole Parmer building and the 200 thousand square foot Washington Mutual Mortgage building. Adjacent to the Continental Executive Parke a 258 thousand square foot original American Hotel Register building and the newer 201 thousand square foot American Hotel Register distribution center.

The Village has other office building development outside of the large office parks, including office building and small parks built by Hamilton Partners and Trammel Crow. The Village has branches of US Bank, National City Bank, LaSalle Bank of Northbrook, First American Bank, Harris Bank, Fifth Third Bank and Citibank Savings and Loan. The Village has four hotels: the 148 unit AmeriSuites, the 119 unit Hawthorn Suites, the 124-unit Homestead Village and the 128-unit Extended Stay America. A 5% Hotel Motel Tax was extended on these facilities on October 1, 1999. Hotel Motel tax receipts were up 8% from FY2003-04, recovering from last year's anemic results.

In 1988, the Village annexed the Cuneo Estate, which was a 1,200-acre tract of previously undeveloped land. It is zoned to include retail, office park and residential components. The residential and golf course component of this development is called Gregg's Landing. Currently, almost 2,000 homes are planned for development and as of April 30, 2005, 1,892 were constructed or permitted for construction. The development included an 18-hole golf course built on 320 acres of land donated by developers. The Village negotiated with Par Development to build and operate the golf course. The course began operation in 1998 and the lease agreement calls for the lease to terminate on December 31, 2024. The Villages has the right to exercise buy out options in 2013 and 2018, and the Golf Course will automatically revert to the Village in 2024. The Village will begin to receive a share of gross revenues in 2007 at an escalating rate that begins at .01% in 2007 and reaches 20% by 2023 and 2024.

Building activity continued to strengthen for the second year in a row in FY 2004-05. The value of new construction permitted was up 13% from FY2003-04, and up 68% from FY2002-03.

MAJOR INITIATIVES

For the Year. The Village streamlined its operations this year and restructured its utility tax in response to a slow down in the growth of its revenue stream. Starting in November of 2002, concerns about the lack of growth in the sales tax base resulted in the Village instituting a hiring freeze. The failure of sales tax to meet projection during late FY2002-3 and during much of FY2003-04 resulted in a decision by the Village Board to take more permanent actions. An internal study of operations was done. Over two budget years, authorized staffing levels were reduced from 127 full time employees to 115 full time employees through, reassignment of duties, streamlining processes and more use of contracting where it proved cost effective. Public Works was one place where increased contracting reduced the need to maintain prior staff levels significantly. Reassignments were often beneficial to the employee as well as the organization, such as the merging of the information technology coordinator position with the geographic information services specialist position, which resulted in some synergistic improvements and upgraded responsibilities. This staff reduction was combined with a career development incentive program, which encouraged employees to develop new skills.

Revenues were also looked at in a systematic way. Fees and fines were increased to be more in line with the amounts charged by our neighboring communities. Our utility taxes were also reconfigured to generate more revenue with minimal impact on our residents. Previously, we had a 5% gas utility tax and a 1% telecommunications tax. The gas tax currently generates about \$90 thousand per year per each percent of tax. The telecommunications tax generates about \$300 thousand per year per each percent of tax. Because the gas utility tax law was not modernized for deregulation it mainly impacts residents. The telecommunications utility tax more fairly affects business users. By eliminating the gas utility tax and increasing the telecommunications tax from 1% to 4.5%, the Village was able to increase revenues by about \$600,000 while having minimal affect on the residents of the community. This change was approved by the Village Board during FY2004-05, but became effective on July 1, 2005.

Also during FY2004-05, Village participated in a \$9.7 million road project that will extend Fairway Drive from State Route 45 to the intersection at Fairway and Lakeview, which connects directly to State Route 60. This project has been planned since the late 1980s. The road will be a major regional artery that will provide an alternate connection between Routes 45 and 60. This road should help the business climate of the Village, including the ability of employees to get to jobs in Vernon Hills and the ability of shoppers to get to stores in Vernon Hills. There will be substantial financial participation from the Federal Congestion and Mitigation and Air Quality Funds, the Council of Mayors and State road funds. The Village's \$2.7 million share will be funded by proceeds of the Motor Fuel Tax and from a \$505,000 Illinois First grant. Most of this project was completed in FY2004-05.

For the Future During FY2004-05, the Village's Community Development Department continued to work with and negotiate with potential partners to develop a Tax Increment Financing (TIF) District in the area where Routes 45 and 21 intersect. The area is difficult to develop because of the distribution of land ownership and traffic flow obstacles. The College of Lake County is currently adding 50,000 square feet to its facility in Vernon Hills. Also the Village is working with two developers to create a unified planned development, which will include retail, town homes and condominiums. Work is scheduled to begin

during calendar year 2006. While Village participation is contingent upon guaranteed private sector developer

commitments, it is anticipated that over the next few years, the Village could commit up to \$11 million to the project which will be recouped through TIF proceeds or bonds issued based on those proceeds.

Departmental Highlights. During FY2004-05, the Vernon Hills engineering division, in conjunction with the Manager's office and the Vernon Hills Park District began operating VHAC (the Vernon Hills Athletic Complex), formerly known as the Nike Site. The 168-acre site has been partitioned between the Village, Libertyville Community High School District 128, Stevenson High School District 120 and Lincolnshire Prarieview District 103. The Village's 38 acres includes soccer fields and baseball fields, and is will have a memorial commemorating the role that Nike missiles played in the winning of the cold war. During the year, \$650,000 was expended on finalizing this project. Future improvements include additional parking, a bike trail, lighting and landscaping. This facility is already in use including for tournament play.

The engineering division is also working on some water quality projects with the financial assistance of the Army Corps of Engineers and the U.S. Environmental Protection Agency. The Corps is providing 50% of the \$224 thousand to improve water quality in the Village's Lake Harvey. The engineering division is developing the plans and specifications to address the water quality problem in the lake. Removing invasive plants and replacing them with native deep-rooted vegetation, which will reduce sediment deposition, is addressing this. The engineering division is also working on plans and specifications to address erosion concerns, reduce flooding and improve wildlife habitat along the Seavey Drainage Ditch that runs through the Village. This \$362,736 project will receive 50% of its funds from the EPA.

FINANCIAL INFORMATION

Management of the Village is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the Village are protected from loss, theft or misuse and to ensure that adequate accounting data is compiled to allow for the preparation of financial statements in conformity with generally accepted accounting principles. The internal control structure is designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the valuation of costs and benefits requires estimates and judgments by management.

Budgeting Controls. The Village maintains budgetary controls for the governmental funds except for debt service funds where a previously enacted ordinance sets those payment levels. The objective of these controls is to ensure compliance with legal provisions embodied in the annual appropriation ordinance and the annual operating budget. The Village Board approves an annual budget with the Village Manager, designated as budget officer, authorized to approve certain transfers. Items encumbered and budgeted before the close of a particular fiscal year that are not received within the fiscal year are budgeted again in the following year through a carry forward budget transfer. Transfers to reallocate funds are made frequently throughout the fiscal year at the operating budget level through approval of the Village Board. While there were some overages by line item, there were no funds over budget during FY2004-05.

As demonstrated by the statements and schedules included in the financial section of this report, the Village continues meeting its responsibility for sound financial management.

General Government Functions. The following schedule presents a summary of general fund and special revenue fund revenues for the fiscal year ending April 30, 2005 and the amount and percentage of increases and decreases in relation to the revenues of the general fund and the motor fuel tax fund for the fiscal year ending April 30, 2004. Dollar amounts are in thousands.

Revenue Source	Amount	Percent of Total	Increase (Decrease) from FY2003-04	Percent of Increase (Decrease)
Sales tax	\$ 9,983	50.2%	\$ (112)	(1.1)%
Utility tax	1,836	9.2	66	3.7
Income tax	1,435	7.2	221	18.2
Motor Fuel tax	614	3.1	42	7.3
Other taxes	1,451	7.3	136	18.2
Grants	666	3.3	418	168.3
Licenses & permits	2,006	10.1	300	17.6
Charges for service	936	4.7	102	12.3
Fines and forfeits	500	2.5	42	9.1
Investment income	371	1.9	69	22.7
Other revenue	78	0.4	(120)	(60.7)
Total	\$ 19,875	100.0 %	\$ 1,163	

Of the \$1.16 million increase in revenues from FY2003-04, \$418 thousand was in the grants category. Most of this increase was from participation by other governments in the extension of Fairway Drive. Sales tax was down 1.1% due to the adjustments made at CDW, which were explained earlier in this letter. Most of the other revenue sources had moderate to strong increases. In many cases, this growth was a reversal of some reductions experienced over FY2002-03 and FY2003-04.

The following schedule presents a summary of general fund and special revenue funds, and debt service funds expenditures for the fiscal year ended April 30, 2005 and the percentage of increases and decreases in relation to the general fund, special revenue funds, and debt service funds for the fiscal year ended April 30, 2004. Dollar amounts are in thousands.

Function	Amount	Percent of Total	Increase (Decrease) from 2003-04	Percent of Increase (Decrease)
General government	\$ 4,367	23.4 %	\$ 51	1.2
Police department	7,075	37.9	47	0.7
Streets and roads	2,761	14.8	(128)	(4.4)
Economic development	186	1.0	127	216.5
Culture and recreation	441	2.4	22	5.2
Capital outlay	2,276	12.2	(1,078)	(32.1)
Debt service	1551	8.3	(767)	7.3
Total	\$ 18,656	100.0 %	\$ (1,727)	

The majority of the \$1.73 million decrease in expenditures from the prior year was in capital costs. Capital costs were reduced substantially in response to concerns over slowing revenues. Debt service costs were also substantially down from the prior year because last year the Village accelerated the retirement of the 1994 Certificates of Participation debt issue. Economic development costs increased in concert with the progression of the TIF project. Finally, the base costs of the base operating functions were down slightly, despite cost pressures on benefit costs, due to the streamlining of the organization described earlier in the letter.

General Fund Balance. The General Fund balance increased by \$1,853,060 in FY2004–05 to \$20,235,407. This dollar amount represents 119.4% of the expenditures in the General Fund in FY04-05. This fund level is needed to meet the demands of growth and upcoming projects.

Enterprise Operations. The Village operates an Enterprise Fund for the management of the Village’s nine-hole golf course. The Village intends to have the users of the Golf Course pay for its costs. The following schedule shows the operating revenues, expenditures and profits for the fiscal years 2000 - 2001 through 2004 – 05 for the Golf Course enterprise Fund. Dollar amounts are in thousands.

Golf Course Enterprise Fund

	FY 2000 - 2001	FY 2001 -02	FY 2002 - 2003	FY 2003 – 04	FY 2004 - 05
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Revenue	\$ 644	\$ 611	\$ 566	\$ 616	\$ 612
Expenses	635	559	559	579	598
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Profit (losses)	\$ 9	\$ 52	\$ 7	\$ 36	\$ 14

Internal Service Operations. On May 1, 2000, the Village established the Replacement Fund to prefund the cost of large pieces of equipment, primarily, nonpassenger vehicles and nonpolice squad cars. The fund received a \$1,740,000 cash transfer from the General Fund based on estimated amount needed to replace the existing equipment given the estimated lives and future projected departmental lease payments in FY2000-01. In FY2003-04, the fund balance increased by \$83,722 to \$3,535,432.

Pension Trust Fund Operations. The Police Pension Fund had a \$1,465,938 increase in its fund balance in FY2004-05 bringing its balance to \$16,772,072. In FY2004-05, the required supplemental information on employer contributions indicated that the Village contributed 85.51% of what was required. It is important to realize that because the Village does not levy a property tax, GAAP does not allow for as long a grace period to budget the required funds. The actuarial requirement for Vernon Hills in FY2004-05 was determined from April 30, 2004 data that became during FY2004-05. It becomes difficult to budget for the contribution during times when the financial markets are particularly volatile, but a review of the aforementioned table confirms that over a multi-year time horizon, the Village has exceeded required contributions.

Debt Administration. In December of 2004, the Village issued a \$3,540,000 of sales tax general obligation refunding alternate revenue source bonds to defease most of the 2000 sales tax general obligation alternate revenue source bonds. This resulted in a \$166,512 net present value cash flow savings over the life of the bonds, which amounts to a 5.374% savings. During this issuance process, Moody’s reconfirmed the Village’s general obligation Aa1 rating and Standard & Poors reconfirmed the Village’s general obligation AA rating. Subsequent to the close of FY2004-05, in May of 2005, the Village issued a \$3,790,000 of sales tax general obligation refunding alternate revenue source bonds to defease most of the 2001 sales tax general obligation alternate revenue source bonds. Moody’s and Standard & Poors continued to reconfirm the existing bond ratings during that issuance process.

As of April 30, 2005 the four outstanding alternate revenue bonds were the a twenty year \$4.8 million alternate revenue bond issued in 2000 to construct the new Village Hall, a twenty year \$5 million alternate revenue bond issued on May 1, 2001 for the construction of the VHAC site ball fields, the \$4,595,000 and the \$3,540,000 refunding bond just discussed. All of the Village’s alternate revenue bonds are backed by property tax revenue, but it is the intent of the Village to pay the debt service on these bonds through Sales Tax so that no property tax levy will have to be extended. In the case of all of the 2001 VHAC Nike bonds and some of the 2002 VHAC bonds, the Village intends to use the newly instituted Hotel Motel Tax proceeds to pay debt service on these bonds, before using sales tax. As of April 30, 2005 there was

\$690,000 of principal outstanding on the 2000 alternate revenue bond, \$4,375,000 of principal outstanding on the 2001 alternate revenue bond, \$3,565,000 of principal outstanding on the 2002 alternate revenue bonds and \$3,540,000 of principal outstanding on the 2004 refunding alternate revenue bonds.

Cash Management. The Village has adopted an investment ordinance and investment policy for the investment of government funds that permits Village funds to be invested at unlimited amounts in U.S. Treasury Notes and Bills and some federal agencies with maximum maturity terms ranging up to three years, with an allowance for some Treasury Notes to have a maturity of up to seven years. The policy also allows some balance to be invested in collateralized or insured certificates of deposit of financial institutions meeting certain prescribed financial standards. The Village also utilizes the Illinois Public Treasurer's Investment Pool. The Police Pension Fund invests in GNMA obligations, Strip Treasury Coupons, some federal Agencies and insurance separate accounts.

Risk Management. The Village maintains its property, liability and workers compensation coverage through Illinois Municipal League Risk Management Association insurance pool. The pool provides the Village with \$8 million coverage per incident with a \$500 deductible. The pool offers municipalities the option of purchasing additional coverage in excess of \$8 million, which the Village opted to buy. At present, the Village has \$17 million coverage per incident with a \$500 deductible.

OTHER INFORMATION

Independent Audit. The Village is required by state law to have its financial statements examined by an independent accounting firm. This requirement has been fulfilled and the auditors' opinion is included in this report. The Village did not restrict the scope of the auditors' examination, and the opinions expressed are that the financial statements present fairly the financial position and results of operations in conformity with accepted accounting principles.

Awards. The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Village of Vernon Hills for its comprehensive annual financial report for the fiscal year ended April 30, 2004.

In order to be awarded the Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive financial report, whose contents conform to program standards. Such reports must satisfy generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe our current report continues to conform to the Certificate of Achievement Program requirements, and the Village intends to submit this report to the GFOA for its consideration.

Acknowledgments. The hard work, long hours and dedication to quality of Jayshree Taswala and Peggy Koperski in the Finance Department made the preparation of the comprehensive annual financial report possible. I would also like to thank Mary Grampo, for her part-time efforts on behalf of the Finance Department. The staff of the Village Manager's Office, Community Development Department, the Police Department and the Public Works Department provided additional important support. The assistance and suggestions of our auditing firm, Lauterbach & Amen, LLP have contributed greatly to the success of this report and the financial operations of the Village. The leadership and support provided by the Village President and Village Board were essential to the preparation of this report.

Sincerely,

Michael S. Allison
Village Manager

Laurence Nakrin, MBA, CPA, CCM, CFA
Finance Director / Treasurer