

CITY OF NEWPORT NEWS, VIRGINIA

Management's Discussion and Analysis

The following is a narrative overview and analysis of the financial activities of the City of Newport News, Virginia (the City) as of and for the fiscal year ended June 30, 2007. This discussion and analysis is intended to serve as an introduction to the City's basic financial statements, which have the following components: (1) management's discussion and analysis (MD&A), (2) government-wide financial statements, (3) fund financial statements, and (4) notes to the financial statements.

FINANCIAL HIGHLIGHTS FOR FISCAL YEAR (FY) 2007

General Fund

- At the close of the FY 2007, undesignated fund balance for the General Fund was \$37.4 million or 9.42% of FY 2007 total General Fund revenues and transfers in.
- The General Fund, on a current financial resources basis, reported an increase of revenues and other financing sources over expenditures and other financing uses of \$7.6 million, primarily due to higher than expected tax revenues, coupled with restrained spending by department managers.
- General Fund revenues and transfers increased \$24.0 million or 6.4% over FY 2006, due to growth in general property taxes, primarily real property taxes. Expenditures and transfers out increased \$21.5 million, 5.8% higher than last fiscal year. However, FY 2007 expenditures and transfers out were 2.0% less than budget.
- The City's real estate tax rate was lowered to \$1.20 from \$1.24 per \$100 of assessed valuation for FY 2007. The real estate tax rate has been reduced to \$1.10 per \$100 of assessed valuation beginning in FY 2008. These decreases were in responses to assessment increases over the past four years. The tax rate on personal property of \$4.25 of assessed valuation remained unchanged

Governmental Activities

- The assets of the City, for its governmental activities, exceeded its liabilities at the close of the FY 2007 by \$189.7 million (*net assets*). Of this amount, \$2.2 million is restricted.
- The City's total bonded debt increased by approximately \$10.5 million during the current fiscal year, due to the issuance of \$62.3 million and payments of \$51.7 million (\$30.7 million scheduled repayment of principal and \$21.0 million refunded).

Business-Type Activities

- Effective in FY 2007, the Parking Authority is reported with the City's component unit, Economic and Industrial Development Authority. The Parking Authority is no longer reported as a Business-Type Activity.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the City's basic financial statements. The City's basic financial statements comprise three components: *government-wide financial statements, fund financial statements, and notes to the financial statements*. This report also contains other supplementary information in addition to the basic financial statements themselves.

- The first two statements are government-wide financial statements that provide both long-term and short-

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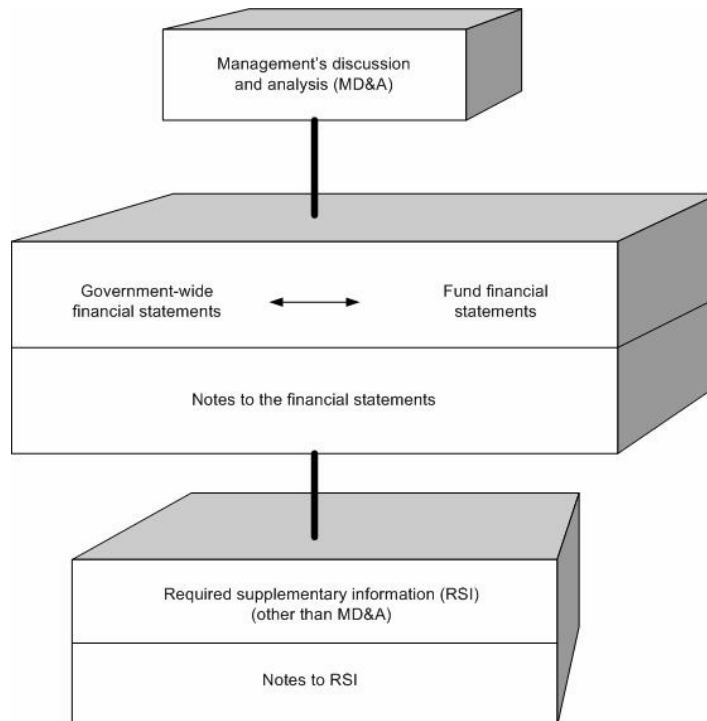
term information about the City's overall financial status.

- The remaining statements are fund financial statements that focus on individual parts of the City's government, reporting the City's operations in more detail than the government-wide statements.
 - *Governmental fund* statements tell how general government services like public safety were financed in the short term as well as what amounts remain for future spending.
 - *Proprietary fund* statements offer short- and long-term financial information about the activities the government operates like businesses, such as the public utilities (water) system.
 - *Fiduciary fund* statements provide information about the financial relationships in which the City acts solely as a trustee or agent for the benefit of others, to whom the resources in question belong.

The financial statements also include *notes* that explain some of the information in the financial statements and provide more detailed data. The statements are followed by a section of required supplementary information that further explains and supports the information in the financial statements. Figure A shows how the required parts of this Management's Discussion and Analysis and the City's basic financial statements are arranged and relate to one another.

Figure A

Required Components of Newport News' Financial Statements



In the past, the primary focus of local government financial statements has been summarized fund type information on a current financial resources basis. However, with the implementation of Statement No. 34 of the Governmental Accounting Standards Board (GASB Statement No. 34) for June 30, 2002, the new focus is on both the City as a whole (government-wide) and the fund financial statements. Each view provides a

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different snapshot of the City's finances. The government-wide financial statements, which were new for fiscal year 2002, provide both long-term and short-term information about the City's overall financial status. The fund financial statements, which have been provided in the past, focus on the individual parts of the City government, reporting the City's operations in more detail than the government-wide statements. Both perspectives (government-wide and fund) allow the user to address relevant questions, broaden the basis of comparison (year-to-year or government-to-government) and enhance the City's accountability.

Government-Wide Statements

The government-wide statements report information about the City as a whole using accounting methods similar to those used by private-sector companies. The Statement of Net Assets and the Statement of Activities, which are the government-wide statements, include all of the government's assets and liabilities using the accrual basis of accounting, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two government-wide statements report the City's net assets and how they have changed. Net assets—the difference between the City's assets and liabilities—is one way to measure the City's financial health, or financial position. Over time, increases or decreases in the City's net assets are an indicator of whether its financial health is improving or deteriorating. Other non-financial factors, such as changes in the City's property tax base and the condition of the City's roads and other infrastructure, may need to be considered to assess the overall health of the City.

In the Statement of Net Assets and the Statement of Activities, the City is divided into three categories:

- *Governmental activities* – Most of the City's basic services are included here, such as the police, fire, public works, parks, and general administration. Taxes, state and federal grants finance most of these activities.
- *Business-type activities* – The City charges fees to customers to help cover the costs of certain services it provides. The City's water facility is included here.
- *Component units* – The City includes three separate legal entities in its report - the Peninsula Airport Commission, the Economic and Industrial Development Authorities, and the Newport News Public Schools. Although legally separate, these "component units" are important because the City is financially accountable for them, and provides operating funding.

Fund Financial Statements

The format of the fund financial statements will be more familiar to traditional users of government financial statements. The fund financial statements provide more detailed information about the City's most significant funds, not the City as a whole. Funds are accounting mechanisms that the City uses to keep track of specific sources of funding and spending for particular purposes. Some funds are required by State law and by bond covenants; City Council establishes other funds to control and manage money for particular purposes or to show that it is properly using certain taxes and grants.

The City has three kinds of funds:

- *Governmental funds* – Most of the City's basic services are included in governmental funds, which focus on (1) how cash and other financial assets that can readily be converted to cash flow in and out and (2) the balances remaining at year-end that are available for spending. Consequently, the governmental fund statements provide a detailed short-term view that helps the reader determine whether there are more or fewer financial resources that can be spent in the near future to finance the City's programs. Because this

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information does not encompass the additional long-term focus of the government-wide statements, additional information is provided on a subsequent page that explains the relationship (or differences) between the government-wide and fund statements.

- *Proprietary funds* – The City maintains two different types of proprietary funds. (1) Enterprise funds are used to report the same functions presented as business-type activities in the government-wide financial statements. Enterprise funds include the Public Utility Fund. (2) Internal service funds are an accounting device used to accumulate and allocate costs internally among the City's various functions. The City uses internal service funds to account for the operation of vehicles and equipment.
- *Fiduciary fund* – The City is the trustee, or fiduciary, for certain donated funds. It is also responsible for other assets that, because of a trust arrangement, can be used only for the trust beneficiaries. The City is responsible for ensuring that the assets reported in this fund are used for their intended purpose. The fiduciary funds include the Pension Trust Fund and Agency Funds. These activities are reported in a separate statement of fiduciary net assets. The City excludes this activity from its government-wide financial statements because the City cannot use these assets to finance its operations.

The Total Governmental Funds column requires reconciliation because of the different measurement focus from the government-wide statements (current financial resources versus total economic resources) which is reflected on the page following each statement. The flow of current financial resources will reflect bond proceeds and interfund transfers as other financing sources as well as capital expenditures and bond principal payments as expenditures. The reconciliation will eliminate these transactions and incorporate the capital assets and long-term obligations (bonds and others) into the Governmental Activities column (in the government-wide statements).

Notes to the Basic Financial Statements

The notes to the financial statements provide additional information that is essential for a full understanding of the information provided in the government-wide and fund financial statements. The notes also present certain required supplementary information concerning the City's progress in funding its obligation to provide pension benefits to its employees.

FINANCIAL ANALYSIS OF THE CITY AS A WHOLE

This is the sixth year that the City has presented its financial statements under the new reporting model required by GASB Statement No. 34. This reporting model changes significantly both the recording and presentation of financial data. Prior year information is shown in the following comparative analysis of government-wide information.

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Statement of Net Assets

The following table reflects the condensed net assets:

Table 1 - Summary of Net Assets (in millions):

	<u>Governmental</u>		<u>Business-Type</u>		<u>Total Primary</u>	
	<u>Activities</u>		<u>Activities **</u>		<u>Government</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Current and other assets	\$ 177.0	152.4	90.8	60.6	267.8	213.0
Capital assets, net	<u>604.3</u>	<u>578.6</u>	<u>422.2</u>	<u>412.5</u>	<u>1,026.5</u>	<u>991.1</u>
Total assets	<u>\$ 781.3</u>	<u>731.0</u>	<u>513.0</u>	<u>473.1</u>	<u>1,294.3</u>	<u>1,204.1</u>
Current and other liabilities	\$ 92.2	85.6	27.2	27.1	119.4	112.7
Long-term liabilities	<u>499.4</u>	<u>454.0</u>	<u>192.1</u>	<u>162.7</u>	<u>691.5</u>	<u>616.7</u>
Total liabilities	<u>591.6</u>	<u>539.6</u>	<u>219.3</u>	<u>189.8</u>	<u>810.9</u>	<u>729.4</u>
Net assets:						
Invested in capital assets, net of related debt	190.9	175.3	218.4	264.9	409.3	440.2
Restricted net assets	2.2	1.5	50.7	0.2	52.9	1.7
Unrestricted net assets	<u>(3.4)</u>	<u>14.6</u>	<u>24.6</u>	<u>18.2</u>	<u>21.2</u>	<u>32.8</u>
Total net assets	<u>189.7</u>	<u>191.4</u>	<u>293.7</u>	<u>283.3</u>	<u>483.4</u>	<u>474.7</u>
Total liabilities and net assets	<u>\$ 781.3</u>	<u>731.0</u>	<u>513.0</u>	<u>473.1</u>	<u>1,294.3</u>	<u>1,204.1</u>

** Business-Type Activities: FY 2006 includes Public Utility and Parking Authority. FY 2007 includes Public Utility.

Net assets (assets over liabilities) may serve over time as a useful indicator of a government's financial position. In the case of the City, assets exceeded liabilities by \$483.4 million at the close of fiscal year 2007. By far the largest portion of the City's net assets (85%) reflects its investment in capital assets (e.g., land, buildings, equipment, infrastructure), less accumulated depreciation and less any related outstanding debt used to acquire those assets. The City uses these assets to provide services to its citizens and consequently, these assets are *not* available for future spending. The resources needed to repay the debt related to these capital assets must be provided from other sources. Although the City's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

Approximately 11% of the City's net assets are subject to external restrictions. The remaining balance of unrestricted net assets (\$21.2 million or 4%) may be used to meet the City's ongoing obligations to citizens and creditors.

Governmental Activities

Net assets of the City's governmental activities decreased from \$191.4 million at June 30, 2006 to \$189.7 million at June 30, 2007 as a result of a decrease in net assets of \$1.7 million as shown on the Statement of Activities and in Table 2 on the next page.

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Business-Type Activities

Effective July 1, 2007, the Parking Authority Fund was moved from the City's Business Type Activities to Economic & Industrial Development Authorities, a component unit of the City. Public Utility is the City's enterprise operation. The net assets of Public Utility increased from \$279.8 million to \$293.7 million. The City generally can only use these net assets to finance the continuing operations of its enterprise operation, Public Utility.

Statement of Activities

The following table shows the revenues and expenses of the governmental and business-type activities:

Table 2 - Changes in Net Assets (in millions):

	<u>Governmental Activities</u>		<u>Business-Type Activities</u>		<u>Total Primary Government</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Revenues:						
Program revenues:						
Charges for services	\$ 54.0	50.9	71.9	72.4	125.9	123.3
Operating grants and contributions	44.1	43.9	-	-	44.1	43.9
Capital grants and contributions	2.8	3.0	-	-	2.8	3.0
General revenues:						
Property taxes	207.8	187.9	-	-	207.8	187.9
Other taxes	90.4	89.2	-	-	90.4	89.2
Grants and contributions not restricted to specific programs	48.3	45.5	-	-	48.3	45.5
Investment earnings	6.5	5.0	1.9	1.2	8.4	6.2
Miscellaneous	11.1	11.6	3.5	3.8	14.6	15.4
Total revenues	<u>465.0</u>	<u>437.0</u>	<u>77.3</u>	<u>77.4</u>	<u>542.3</u>	<u>514.4</u>
Expenses:						
General government	54.6	65.0	-	-	54.6	65.0
Judicial administration	6.9	6.4	-	-	6.9	6.4
Public safety	112.1	100.5	-	-	112.1	100.5
Public works	66.3	63.7	-	-	66.3	63.7
Health and welfare	56.1	53.4	-	-	56.1	53.4
Education	117.5	104.0	-	-	117.5	104.0
Parks, recreation and culture	32.5	29.9	-	-	32.5	29.9
Community development	8.7	11.2	-	-	8.7	11.2
Public Utility	-	-	54.3	51.4	54.3	51.4
Parking Authority	-	-	-	0.2	-	0.2
Interest on long-term debt	21.1	17.2	-	-	21.1	17.2
Total expenses	<u>475.8</u>	<u>451.3</u>	<u>54.3</u>	<u>51.6</u>	<u>530.1</u>	<u>502.9</u>
Excess (deficiency) before transfers	(10.8)	(14.3)	23.0	25.8	12.2	11.5
Transfers	9.1	9.1	(9.1)	(9.1)	-	-
Increase (decrease) in net assets	(1.7)	(5.2)	13.9	16.7	12.2	11.5
Beginning Net Assets, as restated	191.4	196.6	279.8	266.6	471.2	463.2
Ending Net Assets	<u>\$ 189.7</u>	<u>191.4</u>	<u>293.7</u>	<u>283.3</u>	<u>483.4</u>	<u>474.7</u>

** Business-Type Activities: FY 2006 includes Public Utility & Parking Authority. FY 2007 includes Public Utility.

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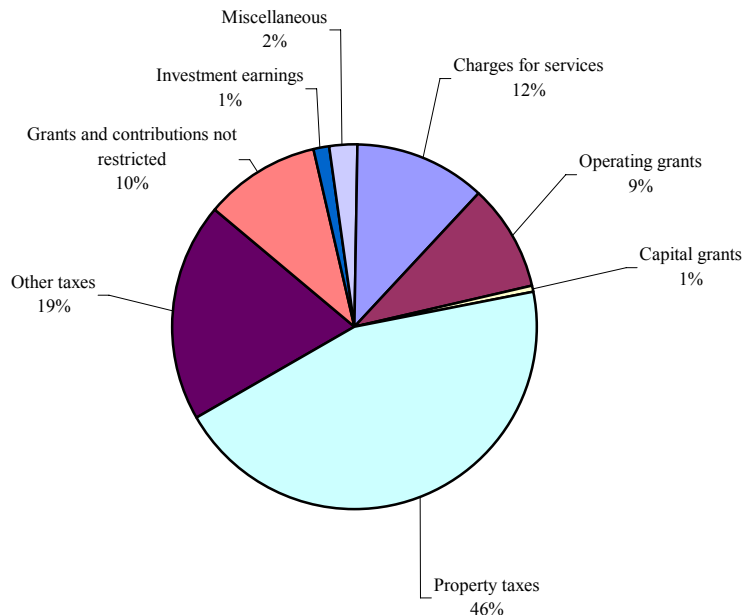
Governmental Activities

The City's total revenues from governmental activities were \$465.0 million for the fiscal year ended June 30, 2007. The largest source of revenue (\$207.8 million for fiscal year 2007) for the City is property taxes, composed of real estate and personal property taxes. The City's assessed real property tax base for fiscal year 2007 increased 18%. The significant increase resulted in City Council lowering the tax rate from \$1.24 to \$1.10. The City Council has also voted to reduce the tax rate by an additional \$.10 effective July 1, 2007.

Approximately 65% of the City's revenue from governmental activities comes from some type of tax, and 12% comes from fees charged for services.

The City's expenses cover a wide range of services, with 24% or \$112.1 million for fiscal year 2007 related to public safety and 25% or \$117.5 million for fiscal year 2007 for education (payments to the Public Schools, a component unit).

Revenues by Source – Governmental Activities



Business-Type Activities

Net assets for the City's business-type activities increased by \$13.9 million, resulting mainly from connection fees in the amount of \$3.5 million and an increase from operations of \$22.9 million. Charges for services make up 93% of total revenues for business-type activities.

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FINANCIAL ANALYSIS OF THE CITY'S FUNDS

The City of Newport News uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

General Fund

The General Fund is the chief operating fund of the City. At the end of the current fiscal year, unreserved fund balance was \$98.8 million of which \$37.4 million represents undesignated fund balance of the General Fund. As a measure of the general fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balances represent 27% of the total fund expenditures, while total fund balance represents 31% of that same amount.

Debt Service Fund

The debt service fund has a fund balance of \$1.3 million. During the current fiscal year, the fund balance increase of \$0.9 million is a net result of bonds refunded, bonds issued and annual debt payments.

Bond Fund

The bond fund accounts for the proceeds of all general obligation bond issues except those of the Proprietary Funds. At the end of the current fiscal year, the bond fund balance has a balance of \$5.2 million.

Proprietary Funds

The City's proprietary fund statements provide the same type of information found in the government-wide financial statements, but in more detail.

Growth in net assets was \$13.9 million, resulting mainly from connection fees in the amount of \$3.5 million and an increase from operations of \$22.9 million.

GENERAL FUND BUDGETARY HIGHLIGHTS

Fiscal Year 2007

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual</u>
Revenues:			
Taxes	\$ 292,726,462	292,726,462	298,540,758
Intergovernmental	45,259,739	45,557,387	48,308,625
Other	<u>46,655,922</u>	<u>46,622,802</u>	<u>49,953,113</u>
Total	<u>384,642,123</u>	<u>384,906,651</u>	<u>396,802,496</u>
Expenditures and Transfers:			
Expenditures	346,257,805	352,017,116	344,136,621
Transfers out	<u>38,384,318</u>	<u>45,274,532</u>	<u>45,238,974</u>
Total	<u>384,642,123</u>	<u>397,291,648</u>	<u>389,375,595</u>
Change in fund balance	\$ <u><u>-</u></u>	<u><u>(12,384,997)</u></u>	<u><u>7,426,901</u></u>

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The difference between the original budget and the final amended budget for the City's General Fund expenditures was approximately \$12.4 million (increase in appropriations). The variance is mainly due to the following:

- \$7.72 million – Information Technology
- \$3.60 million – Capital projects
- \$0.40 million – Tax case litigation and refund
- \$0.35 million – Jamestown Settlement Contribution
- \$0.12 million – Parks and Recreation
- \$0.08 million – Police Emergency Medical Dispatch Program
- \$0.05 million – Community Service (Youth Career Program)
- \$0.05 million – Treasurer Cashiering System

Actual General Fund revenues and transfers from other funds were above the final budgeted revenues by \$11.9 million. Expenditures and transfers out were under budget by \$7.9 million. This positive budget variance helped to partially offset the planned use of undesignated fund balance.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

The City's investment in capital assets for its governmental and business-type activities as of June 30, 2007 amounts to \$1,026 million (net of depreciation). This investment includes land, buildings and improvements, drainage and water/sewer systems, machinery and equipment, roads, bridges, and construction in progress.

Major capital asset events during the fiscal year included the following:

- Construction in progress totaled \$12.4 million for governmental activities at the end of the fiscal year (including certain Public Schools projects under construction).
- Construction in progress totaled \$49.9 million for business-type activities at the end of the fiscal year and relates to the following projects: regional raw water supply costs, Lee Hall Treatment Plant modifications, Harwoods Mill Dam Spillway improvements, Colonial Pipeline and customer information system.

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City of Newport News' Capital Assets (net of depreciation):

	Governmental Activities		Business-Type Activities **		Total	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Land	\$ 79,449,349	79,449,349	5,444,271	6,176,118	84,893,620	85,625,467
Construction in progress	12,432,697	42,174,547	49,942,970	40,803,792	62,375,667	82,978,339
Buildings	239,572,626	198,142,923	14,444,076	14,730,585	254,016,702	212,873,508
Water systems	-	-	344,808,758	341,950,332	344,808,758	341,950,332
Improvements	64,226,446	66,635,300	2,088,915	3,507,942	66,315,361	70,143,242
Machinery and equipment	43,514,824	40,181,648	5,494,013	5,296,142	49,008,837	45,477,790
Infrastructure	165,163,545	152,031,504	-	-	165,163,545	152,031,504
Total	\$ 604,359,487	578,615,271	422,223,003	412,464,911	1,026,582,490	991,080,182

** Business-Type Activities: FY 2006 includes Public Utility and Parking Authority. FY 2007 includes Public Utility.

Additional information on the City's capital assets can be found in note 4 to the basic financial statements.

Long-Term Debt

At the end of the current fiscal year, the City had total bonded debt outstanding (including literary loans) of \$576.0 million, an increase of 1% over last year, as shown in the table below. Capital leases, landfill liability, accrued vacation and claims payable are not included in these figures.

City of Newport News' Outstanding Debt, General Obligation Bonds and Literary Loans (in millions):

	Governmental Activities		Business-Type Activities		Total	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
General obligation bonds	\$ 411.5	401.0	155.2	166.5	566.7	567.5
Literary loans	9.3	2.9	-	-	9.3	2.9
Total	\$ 420.8	403.9	155.2	166.5	576.0	570.4

The amount of the debt outstanding related to School Board activities is \$129.2 million of the total outstanding general obligation bonds of the governmental activities.

The City issued new debt during the year totaling \$62.3 million in the form of general obligation bonds.

The City maintains an Aa rating from Standard & Poor's Corporation. Under Moody's Investors Service, the City maintains an Aa2 rating.

Additional information on the City's long-term debt can be found in Note 7 to the basic financial statements.

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ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS

The unemployment rate in June 2007 for the City of Newport News was 3.4%, which is a decrease from the average for 2006 of 4.2%. The City's annual population growth rate decreased from approximately 186,000 at the end of fiscal year 2006 to 178,281 at the end of fiscal year 2007.

The growth in assessed real estate values allowed the City to lower the real estate tax rate effective July 1, 2007 from \$1.20 per \$100 in assessed value to \$1.10 per \$100.

CONTACTING THE CITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide citizens, taxpayers, customers, investors, and creditors with a general overview of the City's finances and to demonstrate the City's accountability for the funds it receives. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Director of Finance, 2400 Washington Avenue, Newport News, Virginia 23607.