

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, 2008. 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) 2008

General Fund

- At the close of the FY 2008, undesignated fund balance for the General Fund was \$41.2 million or 10% of FY 2008 total General Fund revenues and transfers in.
- General Fund revenues and transfers increased \$15.0 million or 3.8% over FY 2007, due to growth in general property taxes, primarily real property taxes. Expenditures and transfers out increased \$34.4 million, 8.8% higher than last fiscal year. However, FY 2008 expenditures and transfers out were 2.4% less than budget.
- The City's real estate tax rate was lowered to \$1.10 from \$1.20 per \$100 of assessed valuation for FY 2008. This decrease was 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 2008 by \$187.8 million (*net assets*). Of this amount, \$1.9 million is restricted.
- The City's total bonded debt decreased by approximately \$0.4 million during the current fiscal year, due to the issuance of \$34.8 million and principal payments of \$35.2 million.
- At the end of the current fiscal year, the City had long-term liabilities of \$530.1 million, an increase of \$30.7 million or approximately 6% over last year. This increase was mainly due to increases in pension and OPEB obligations of \$24.7 million and \$4.8 million, respectively. The significant increase in long-term liability resulted in a negative unrestricted assets of \$37.3 million.

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-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.

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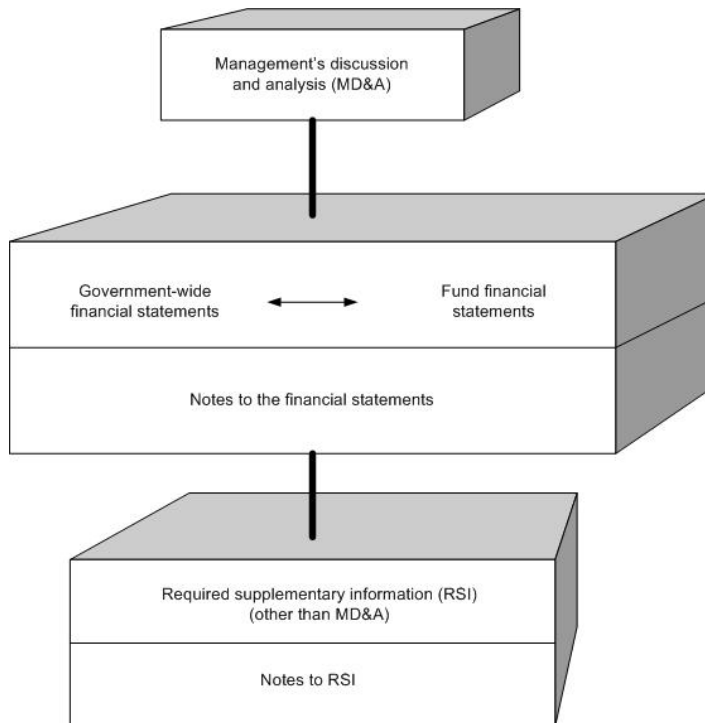
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- *Governmental fund* statements tell how general government services like public safety were financed in the short term as well as what amounts remain for future spending.
- *Proprietary fund* statements offer short- and long-term financial information 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



The government-wide financial statements provide both long-term and short-term information about the City's overall financial status. The fund financial statements 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.

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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 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.

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- *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):

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2008	2007	2008	2007	2008	2007
Current and other assets	\$ 178.5	177.0	105.0	90.8	283.5	267.8
Capital assets, net	627.2	604.3	432.9	422.2	1,060.1	1,026.5
Total assets	<u>\$ 805.7</u>	<u>781.3</u>	<u>537.9</u>	<u>513.0</u>	<u>1,343.6</u>	<u>1,294.3</u>
Current and other liabilities	\$ 87.8	92.2	24.9	27.2	112.7	119.4
Long-term liabilities	530.1	499.4	205.9	192.1	736.0	691.5
Total liabilities	<u>\$ 617.9</u>	<u>591.6</u>	<u>230.8</u>	<u>219.3</u>	<u>848.7</u>	<u>810.9</u>
Net assets:						
Invested in capital assets, net of related debt	223.3	190.9	277.8	218.4	501.1	409.3
Restricted net assets	1.8	2.2	-	50.7	1.8	52.9
Unrestricted net assets	(37.3)	(3.4)	29.3	24.6	(8.0)	21.2
Total net assets	<u>\$ 187.8</u>	<u>189.7</u>	<u>307.1</u>	<u>293.7</u>	<u>494.9</u>	<u>483.4</u>
Total liabilities and net assets	<u>\$ 805.7</u>	<u>781.3</u>	<u>537.9</u>	<u>513.0</u>	<u>1,343.6</u>	<u>1,294.3</u>

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 \$494.9 million at the close of fiscal year 2008. By far the largest portion of the City's net assets 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.

Less than 1% of the City's net assets are subject to external restrictions. There are no net assets available that 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 \$189.7 million at June 30, 2007 to \$187.8 million at June 30, 2008 as a result of a decrease in net assets of \$1.9 million as shown on the Statement of Activities and in Table 2 on the next page.

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Business-Type Activities

Public Utility is the City's enterprise operation. The net assets of Public Utility increased from \$293.7 million to \$307.1 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):

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2008	2007	2008	2007	2008	2007
Revenues:						
Program revenues:						
Charges for services	\$ 56.3	54.0	76.0	71.9	132.3	125.9
Operating grants and contributions	45.8	44.1	-	-	45.8	44.1
Capital grants and contributions	2.1	2.8	-	-	2.1	2.8
General revenues:						
Property taxes	219.9	207.8	-	-	219.9	207.8
Other taxes	93.1	90.4	-	-	93.1	90.4
Grants and contributions not restricted to specific programs	49.4	48.3	-	-	49.4	48.3
Investment earnings	6.2	6.5	3.0	1.9	9.2	8.4
Miscellaneous	10.8	11.1	3.8	3.5	14.6	14.6
Total revenues	<u>483.6</u>	<u>465.0</u>	<u>82.8</u>	<u>77.3</u>	<u>566.4</u>	<u>542.3</u>
Expenses:						
General government	54.9	54.6	-	-	54.9	54.6
Judicial administration	7.3	6.9	-	-	7.3	6.9
Public safety	119.0	112.1	-	-	119.0	112.1
Public works	70.6	66.3	-	-	70.6	66.3
Health and welfare	58.6	56.1	-	-	58.6	56.1
Education	114.2	117.5	-	-	114.2	117.5
Parks, recreation and culture	36.2	32.5	-	-	36.2	32.5
Community development	10.6	8.7	-	-	10.6	8.7
Public Utility	-	-	59.4	54.3	59.4	54.3
Interest on long-term debt	24.1	21.1	-	-	24.1	21.1
Total expenses	<u>495.5</u>	<u>475.8</u>	<u>59.4</u>	<u>54.3</u>	<u>554.9</u>	<u>530.1</u>
Excess (deficiency) before transfers	(11.9)	(10.8)	23.4	23.0	11.5	12.2
Transfers	10.0	9.1	(10.0)	(9.1)	-	-
Increase (decrease) in net assets	(1.9)	(1.7)	13.4	13.9	11.5	12.2
Beginning Net Assets, as restated	189.7	191.4	293.7	279.8	483.4	471.2
Ending Net Assets	<u>\$ 187.8</u>	<u>189.7</u>	<u>307.1</u>	<u>293.7</u>	<u>494.9</u>	<u>483.4</u>

Governmental Activities

The City's total revenues from governmental activities were \$483.6 million for the fiscal year ended June 30, 2008. The largest source of revenue (\$219.9 million for fiscal year 2008) 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 15%. The significant increase resulted in City Council lowering the tax rate from \$1.20 to \$1.10.

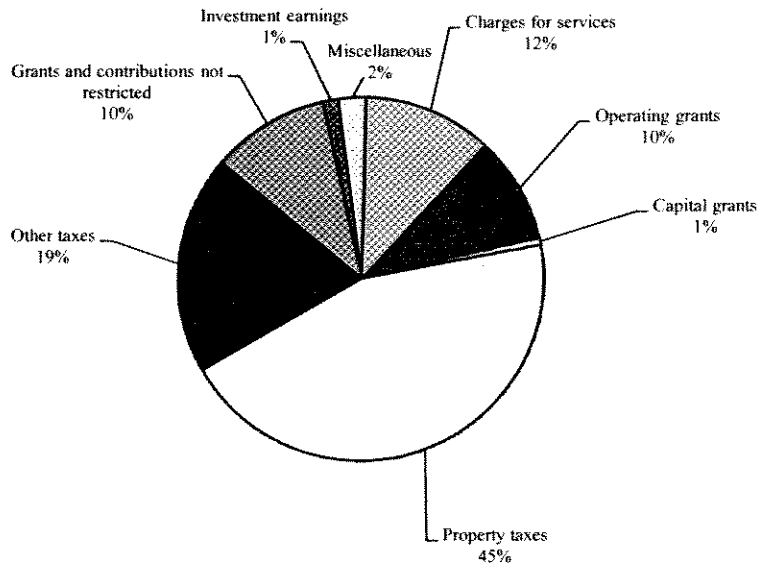
Approximately 64% of the City's revenue from governmental activities comes from some type of tax, and 12% comes from fees charged for services.

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The City's expenses cover a wide range of services, with 24% or \$119.0 million for fiscal year 2008 related to public safety and 23% or \$114.2 million for fiscal year 2008 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 \$13.4 million, resulting mainly from connection fees in the amount of \$4.9 million and an increase from operations of \$22.5 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 \$87.7 million of which \$41.2 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 24% of the total fund expenditures, while total fund balance represents 25% of that same amount.

Debt Service Fund

The debt service fund has a fund balance of \$2.8 million. During the current fiscal year, the fund balance increase of \$1.5 million is a net result of 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 accounts has a balance of \$13.7 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 \$13.4 million, resulting mainly from connection fees in the amount of \$4.9 million and an increase from operations of \$22.5 million.

GENERAL FUND BUDGETARY HIGHLIGHTS

Fiscal Year 2008

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual</u>
Revenues:			
Taxes	\$ 312,168,915	312,168,915	312,477,504
Intergovernmental	49,745,411	49,872,921	49,350,467
Other	49,573,954	49,573,954	49,941,629
Total	<u>411,488,280</u>	<u>411,615,790</u>	<u>411,769,600</u>
Expenditures and Transfers:			
Expenditures	368,596,080	370,200,430	359,818,338
Transfers out	42,892,200	63,392,200	63,392,200
Total	<u>411,488,280</u>	<u>433,592,630</u>	<u>423,210,538</u>
Change in fund balance	\$ <u>-</u>	<u>(21,976,840)</u>	<u>(11,440,938)</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 \$22.0 million (increase in appropriations). The variance is mainly due to the following:

\$	7.00	million	Capital Projects
	3.50	million	Sanitary Sewer Consent Order
	2.40	million	Real Estate Appraisers' System
	2.00	million	City Buildings & Parking Lot Improvements
	1.60	million	Fire Projects & Equipment
	1.30	million	Police Projects
	1.20	million	Information Technology
	1.00	million	Southeast Waterfront Fund
	0.60	million	Refuse Trucks
	0.50	million	City-wide Special Events
	0.40	million	Parks Improvement Projects
	0.40	million	Security Camera System
	0.10	million	Codes Demolition Program

Actual General Fund revenues and transfers from other funds were above the final budgeted revenues by \$0.1 million. Expenditures and transfers out were under budget by \$10.4 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, 2008 amounts to \$1,060.1 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 \$22.4 million for governmental activities at the end of the fiscal year (including certain Public Schools projects under construction).
- Construction in progress totaled \$44.7 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 and Harwoods Mill Dam Spillway improvements.

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

	Governmental Activities		Business-Type Activities		Total	
	2008	2007	2008	2007	2008	2007
Land	\$ 81,434,671	79,449,349	5,476,694	5,444,271	86,911,365	84,893,620
Construction in progress	22,357,501	12,432,697	44,689,472	49,942,970	67,046,973	62,375,667
Buildings	240,646,107	239,572,626	14,109,548	14,444,076	254,755,655	254,016,702
Water systems	-	-	349,208,746	344,808,758	349,208,746	344,808,758
Improvements	64,140,044	64,226,446	2,120,804	2,088,915	66,260,848	66,315,361
Machinery and equipment	52,285,130	43,514,824	17,295,494	5,494,013	69,580,624	49,008,837
Infrastructure	166,332,633	165,163,545	-	-	166,332,633	165,163,545
	<u>\$ 627,196,086</u>	<u>604,359,487</u>	<u>432,900,758</u>	<u>422,223,003</u>	<u>1,060,096,844</u>	<u>1,026,582,490</u>

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 \$588.8 million, an increase of 2.2% over last year, as shown in the table below. Capital leases, landfill liability, accrued vacation, net pension obligations, other post employment benefit obligations 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	
	2008	2007	2008	2007	2008	2007
General obligation bonds	\$ 411.1	411.5	168.9	155.2	580.0	566.7
Literary loans	8.8	9.3	-	-	8.8	9.3
Revenue bonds	-	-	40.0	40.0	40.0	40.0
Total	<u>\$ 419.9</u>	<u>420.8</u>	<u>208.9</u>	<u>195.2</u>	<u>628.8</u>	<u>616.0</u>

The amount of the debt outstanding related to School Board activities is \$126.7 million of the total outstanding general obligation bonds of the governmental activities.

The City issued new debt during the year totaling \$34.8 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 2008 for the City of Newport News was 4.0%, which is an increase from the average for 2007 of 3.4%. The City's annual population growth rate increased from approximately 186,000 at the end of fiscal year 2007 to 187,200 at the end of fiscal year 2008.

The FY 2009 approved budget for the General Fund is \$432.2 million, a .3% increase over FY 2008 budget. The FY 2009 budget includes 7,918 positions, a net decrease of 26 positions. Market activity suggests much lower assessed value growth for real estate, and thus less growth in taxes paid in future periods. Due to the declining financial market and the uncertainty due to decreased state funding, the City required all departments to meet an expenditure reduction target for FY 2009.

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.