

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the City of Portsmouth's (City's) Comprehensive Annual Financial Report (CAFR) presents Management's Discussion and Analysis (MD&A) of the City's financial performance during the fiscal year ended June 30, 2010. The MD&A should be read in conjunction with the transmittal letter found in the Introductory Section of this report and the City's financial statements that follow this section.

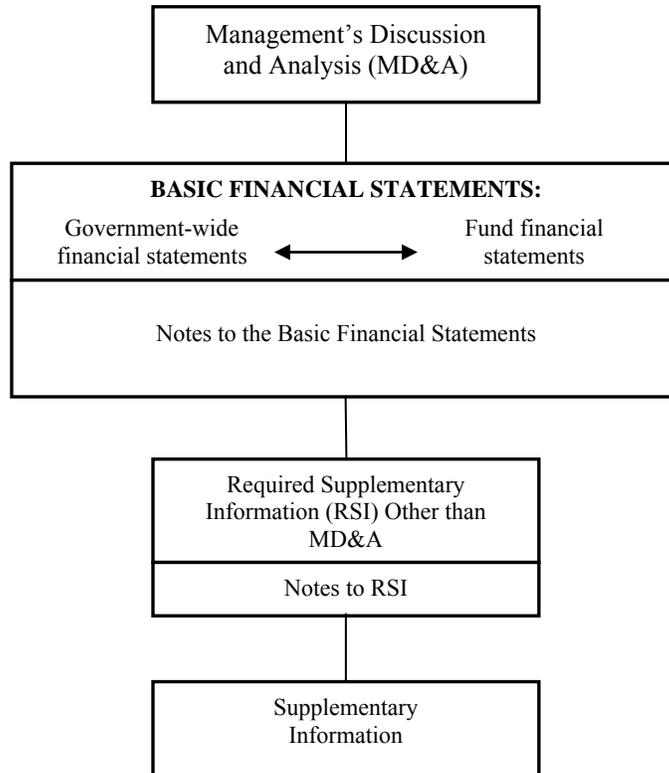
FINANCIAL HIGHLIGHTS

- ❖ The City's net assets totaled \$384 million at June 30, 2010, increasing \$19 million over June 30, 2009. This was in part due to grant funding received as part of the American Recovery and Reinvestment Act of 2009.
- ❖ The City's unrestricted net assets totaled \$85 million, which are comprised of \$52 million resulting from governmental activities and \$33 million resulting from business-type activities.
- ❖ Government-wide current assets totaled \$271 million, of which \$189 million was attributable to governmental activities and \$82 million was attributable to business-type activities; while current liabilities totaled \$45 million, with \$33 million from governmental activities and \$12 million from business-type activities. The ratio of current assets to current liabilities was 6.0:1 overall – 5.7:1 for governmental activities and 6.7:1 for business-type activities.
- ❖ The City's long-term indebtedness at June 30, 2010 (including the portions due in fiscal year 2011) totaled \$507 million, for an increase of \$102 million from the prior year. During fiscal year 2010, the City issued General Obligation debt in the amount of approximately \$108 million which includes \$19 million for a school capital project. The long-term indebtedness includes landfill closure and post-closure care of \$5.6 million and compensated absences of \$8.4 million.
- ❖ The City's general revenues and transfers of \$168 million were \$20 million more than expenses, net of program revenues, of \$154 million. Ninety-eight percent of general revenues and transfers were funded through taxes.
- ❖ The General Fund undesignated fund balance increased 40% during the current year to \$45 million from \$33 million in the prior year.
- ❖ Total net assets for the Public Utility Fund rose 4% from \$138 million at June 30, 2009 to \$144 million at June 30, 2010.

FINANCIAL SECTION OF THE COMPREHENSIVE ANNUAL FINANCIAL REPORT

This Comprehensive Annual Financial Report consists of four sections: introductory, financial, statistical, and compliance. As the following chart shows, the financial section of this report has four components - *management's discussion and analysis* (this section), the *basic financial statements*, the *required supplementary information* and the *supplementary information*. The basic financial statements have three components – *government-wide financial statements*, *fund financial statements*, and *notes to the basic financial statements*.

Components of the Financial Section



The City's financial statements present two kinds of statements each with a different snapshot of the City's finances. 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 and enhance the City's accountability.

Government-wide Financial Statements

The government-wide statements report information about the City as a whole using accounting methods similar to those used by private-sector companies. One of the most important questions asked about the City's finances is, "Is the City, as a whole, better off or worse off as a result of the year's activities?" The Statement of Net Assets and the Statement of Activities, which are the government-wide statements, report information about the City as a whole and about its activities in a manner that provides an answer to this question. These statements include all 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 statements report the City's net assets and changes in net assets. The City's net assets, which is the difference between assets and liabilities, is one way to measure the City's overall financial health and its current financial position. Over time, increases or decreases in the City's net assets are one indicator of whether its financial condition is improving or deteriorating. Other non-financial factors will need to be considered, however, such as changes in the City's property tax base and the condition of the City's roads, to assess the overall health of the City.

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

Governmental activities - The City's basic municipal services, such as public safety (police and fire), public works, parks and recreation, and general administration, are reported herein. Property taxes, other local taxes, and state and federal grants finance most of these activities.

Business-type activities - The City charges fees to cover the full cost of services provided to customers. The City's water and sewer system, port facility and economic development fund, waste management services and golf courses are reported herein. The Parking Authority, a blended component unit, accounts for parking services provided to citizens and customers.

Component units - The City includes 3 other separate legal entities in its report - the School Board, the EDA, and the PPIC, all discretely presented. Although legally separate, these "component units" are important in that the City is financially accountable for providing operating and capital funding to them.

Fund Financial Statements

The focus of the fund financial statement presentation is on the City's most significant funds. The fund financial statements provide more information about the City's most significant funds - not the City as a whole. Funds are accounting units 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. Other funds are established to control and manage money for particular purposes or to demonstrate certain tax and grant revenues are properly used.

The City has three types of funds:

Governmental funds - Most of the City's basic services are included in governmental funds, which focus on (1) the inflows and outflows of cash and other financial assets that can readily be converted into cash and (2) the balances remaining at year end that are available for future spending. Consequently, the governmental funds financial 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 financial statements, additional information is provided on the subsequent page of the governmental funds financial statement that explains the relationship (or differences) between these statements. The City has two major governmental funds, the General Fund and the Capital Improvements Fund.

Proprietary funds - Services for which the City charges customers a fee are generally reported in proprietary funds. Proprietary funds, like the government-wide financial statements, provide both long- and short-term financial information.

In fact, the City's enterprise funds (one type of proprietary fund) are the same as business-type activities, but the fund financial statements provide more detailed and additional information, such as cash flows. The City has 2 major enterprise funds: the Public Utility Fund and the Parking Authority, a blended component unit.

The City uses internal service funds (another type of proprietary fund) to report activities that provide supplies and services for other City programs and activities, such as the City Garage Fund and the Information Technology Fund.

Fiduciary funds - The City is the trustee, or fiduciary, for its employees' pension plans and is responsible for the plans' assets, which can be used only to benefit the trust beneficiaries as part of a trust arrangement. The City is responsible for ensuring that the assets reported in these funds are used for their intended purposes. All of the City's fiduciary activities are reported in a separate statement of fiduciary net assets and a statement of changes in fiduciary net assets. The City excludes these activities from the City's government-wide financial statements in that the City cannot use these assets to finance its operations.

FINANCIAL ANALYSIS OF THE CITY ENTITY

Statements of Net Assets

The following table reflects the condensed Statements of Net Assets:

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2010	2009	2010	2009	2010	2009
Current and other assets	\$ 193	120	84	55	277	175
Capital assets	412	399	221	213	633	612
Total assets	\$ 605	519	305	268	910	787
Current and other liabilities	\$ 33	34	13	11	46	45
Long-term liabilities	344	269	136	109	480	378
Total liabilities	377	303	149	120	526	423
Net assets:						
Invested in capital assets, net of related debt	109	176	123	114	232	290
Restricted	67	13	-	4	67	17
Unrestricted	52	27	33	30	85	57
Total net assets	228	216	156	148	384	364
Total liabilities and net assets	\$ 605	519	305	268	910	787

Net assets (assets in excess of liabilities) may serve over time as a useful indicator of a government's financial position. In the case of the City of Portsmouth, assets exceeded liabilities by \$384 million at June 30, 2010. By far, the largest portion of the City's net assets, 60%, reflects its investment in capital assets (land, buildings, infrastructure, etc.) net of accumulated depreciation and related 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. Approximately 17% of the City's net assets are currently subject to various external restrictions. The remaining balance of unrestricted net assets (\$85 million or 22%) may be used to meet the City's ongoing obligations to citizens and creditors.

The net assets of the City's governmental activities increased by \$12 million from \$216 million to \$228 million, as reflected in the Statement of Activities.

The net assets of the City's business-type activities increased by \$7 million from \$149 million to \$156 million, as reflected in the Statement of Activities.

Statements of Activities

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

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2010	2009	2010	2009	2010	2009
Revenues						
<u>Program revenues:</u>						
Charges for services	\$ 13	12	53	50	66	62
Operating grants and contributions	82	79	1	1	83	80
Capital grants and contributions	5	1	-	-	5	1
<u>General revenues:</u>						
Taxes	165	161	-	-	165	161
Other	3	4	-	1	3	5
Total revenues	268	257	54	52	322	309
Expenses						
General government	26	26	-	-	26	26
Judicial	21	22	-	-	21	22
Public safety	63	60	-	-	63	60
Public works	21	30	-	-	21	30
Health and welfare	39	40	-	-	39	40
Parks, recreational, and cultural	13	13	-	-	13	13
Community development	15	9	-	-	15	9
Education	55	54	-	-	55	54
Public utility	-	-	22	23	22	23
Golf	-	-	2	2	2	2
Parking Authority	-	-	2	2	2	2
Waste management	-	-	14	12	14	12
Interest on long-term debt	10	11	-	-	10	11
Total expenses	263	265	40	39	303	304
Excess (deficiency) before transfers	5	(8)	14	13	19	5
Transfers	7	7	(7)	(7)	-	-
Change in net assets	12	(1)	7	6	19	5
Net assets, beginning of year	216	217	149	143	365	360
Net assets, end of year	\$ 228	216	156	149	384	365

Governmental Activities

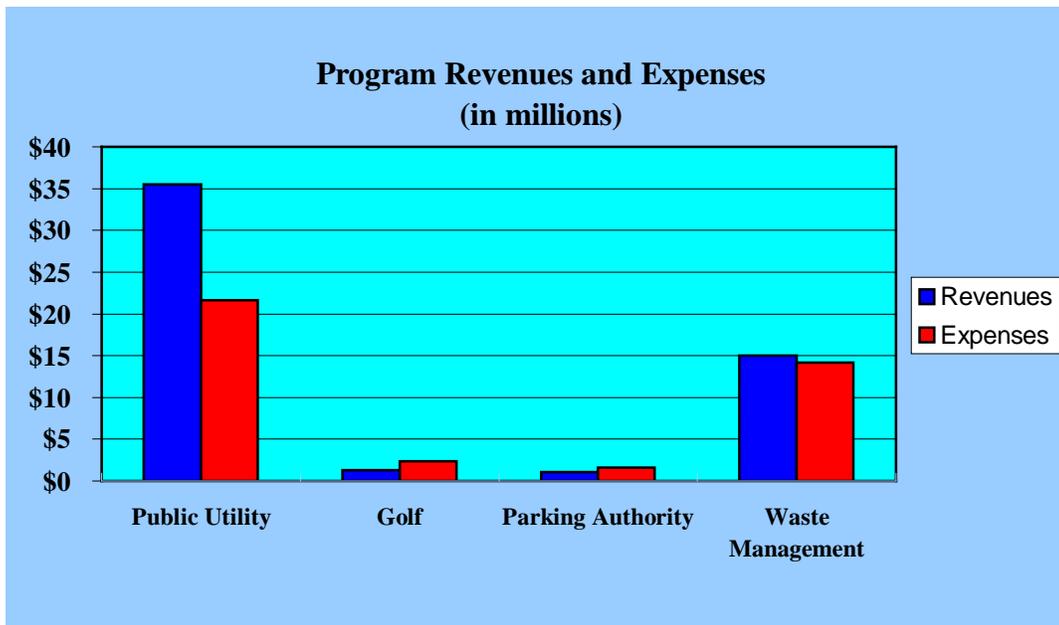
The City's total revenues from governmental activities were \$268 million for the fiscal year ended June 30, 2010, which represents an increase of \$11 million from the prior year. The change is due in part to the increase in the assessment of real property values. The largest source of revenue is taxes, which represents 61% of the total and is comprised of property taxes, other local taxes, and utility taxes. The City's assessed real property value increased 1% from the prior year due solely to new commercial construction.

Program revenues are derived from the program itself and reduce the cost of the function to the City. Total program revenues for governmental activities were \$100 million. The largest component of program revenues for governmental activities is operating grants and contributions totaling \$82 million, representing 82% of total program revenues for governmental activities.

For the fiscal year ended June 30, 2010, expenses for the City's governmental activities totaled \$263 million. The City's expenses cover a wide range of services, with 24% related to public safety, 21% related to education, and 15% related to health and welfare.

Business-Type Activities

The total net assets for business-type activities increased by \$7 million, primarily due to a \$6 million increase in net assets for public utility activities. Charges for services, including water and sewer utility fees, waste management fees, parking fees, and golf fees, represent 97% of total revenues for business-type activities. The following graph compares the program revenues and expenses of the business-type activities.



FINANCIAL ANALYSIS OF THE CITY FUNDS

Governmental Funds

The focus of the City's governmental funds is to provide information on current inflows, outflows, and balances of available resources. Such information is useful in assessing the City's financing requirements. For the fiscal year ended June 30, 2010, the governmental funds reflected a combined fund balance of \$142 million. The General Fund's fund balance totaled \$48 million at June 30, 2010, an increase of \$12 million from the prior year. The General Fund's undesignated fund balance totaled \$45 million at June 30, 2010, which increased by \$12 million from the prior year's undesignated fund balance of \$33 million. The increase is primarily due to stringent

budgeting to reduce expenditures in all departments, a reduction to certain programs and civic organizations, no general wage increase for employees or retirees, an increase in the real estate tax rate and the establishment or amendment of certain fees for services of various city departments.

The City spent \$27 million in the Capital Improvements Fund to fund major projects, including the New Courts Complex, Tidewater Community College infrastructure, Children’s Museum Expansion and Victory Village. The Capital Improvements Fund has a \$72 million fund balance at June 30, 2010, all of which is reserved or designated for future capital project costs.

General Fund Budgetary Highlights

General Fund

Fiscal Year Ended June 30, 2010 (in millions)

	Original Budget	Final Budget	Actual
Revenues, transfers and other financing sources			
Taxes	\$ 161	161	164
Intergovernmental	37	37	36
Other financing sources	-	-	1
Transfer	8	8	8
Other	17	18	15
Total	\$ 223	224	224
Expenditures and transfers			
Expenditures	\$ 209	209	200
Transfers	14	15	12
Total	\$ 223	224	212

Actual expenditures in the above chart are shown on the budgetary basis, which differs from the generally accepted accounting principle basis (see Schedule I-3). The General Fund had a \$12 million dollar increase in fund balance. This increase is primarily due to the decrease in expenditures as a result of management’s decision to review and reduce expenditures in all departments.

Actual General Fund revenues and transfers from other funds were equal to the final budgeted revenues during fiscal year 2010. This was a result of the refined budgeting process and the projections of the City’s financial advisors. Actual general fund expenditures and transfers were \$12 million less than the final budget. This was primarily due to management’s efforts to curtail spending in all departments and a moratorium on travel.

Proprietary Funds

Total net assets of the Public Utility Fund increased \$6 million during fiscal year 2010 from \$138 million to \$144 million. Of the total net assets, \$110 million is invested in capital assets, net of related debt. Unrestricted net assets totaled \$34 million, an increase of \$1 million from the prior year. The increase in net assets is due primarily to the fund’s net income before transfers of \$13 million.

Total net assets of the Parking Authority, a blended component unit, at June 30, 2010 increased from \$847 thousand to \$1 million. Of the total net assets, \$1.5 million is invested in capital assets, net of related debt, and there is an unrestricted net assets deficit of \$485 thousand.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of fiscal year 2010, the City had invested \$633 million in a broad range of capital assets, including machinery and equipment, buildings, park and golf facilities, roads, bridges, and water and sewer lines, as reflected in the following schedule:

Capital Assets (net of depreciation)			
As of June 30, 2010 (in millions)			
	Governmental Activities	Business-Type Activities	Total Primary Government
Land	\$ 17	15	32
Site improvements	1	-	1
Infrastructure	148	-	148
Buildings	141	12	153
Intangibles	1	-	1
Improvements other than buildings	-	105	105
Machinery, furniture, and equipment	13	9	22
Construction in progress	91	80	171
Total	\$ 412	221	633

Major capital asset activity for the fiscal year ended June 30, 2010 included:

- Capital asset additions for governmental activities totaled \$34 million, including \$11 million for infrastructure and machinery and equipment and \$23 million for construction in progress.
- Capital asset additions for business-type activities totaled \$14 million, including \$14 million for construction in progress.
- Depreciation expense totaled \$10 million and \$6 million for governmental and business-type activities, respectively.
- Construction in progress totaled \$91 million for governmental activities at June 30, 2010. (including certain school projects under construction).
- Construction in progress totaled \$80 million for business-type activities at June 30, 2010.

More detailed information about the City's capital assets is presented in Note 4 to the basic financial statements.

The City's fiscal year 2011 capital budget estimates spending another \$54 million for capital projects. The major projects include \$13 million for water and sewer improvements, \$9 million for drainage and sewer improvement, \$31 million for municipal facilities, and \$1 million for education.

Long-term Debt

At year-end, the City had \$445 million in outstanding debt; excluding landfill closure and post closure care costs, and compensated absences. General obligation and revenue bonds outstanding represented \$372 million of this total, as reflected in the following schedule:

Outstanding Debt						
As of June 30, 2010 and 2009 (in millions)						
	Governmental Activities		Business-Type Activities		Total Primary Government	
	2010	2009	2010	2009	2010	2009
General obligation and revenue bonds	\$ 242	\$ 200	130	103	372	303
General obligation notes payable	25	-	-	-	25	-
Obligations under capital leases	14	17	2	3	16	20
Bond Anticipation Note	30	30	-	-	30	30
Literary loans	2	3	-	-	2	3
Total	\$ 313	\$ 250	132	106	445	356

On November 13, 2009, the City sold \$19,000,000 in General Obligation School Bonds (Series 2009) to the Virginia Public School Authority at a true interest cost of 0% and a discount of \$1,777,830. The bonds were issued to fund the construction of Simonsdale Elementary School.

On December 18, 2009, the City sold \$2,404,125 in General Obligation Bonds (Series 2009E) to Virginia Resources Authority (VRA), as Administrator of Virginia Drinking Water Supply Revolving Fund (DWSRF), at a true interest cost of 0%. The bonds were issued to finance the Prentice Park Waterline Replacement Project.

On April 8, 2010, the City issued \$7,035,000 in General Obligation Public Improvement Bonds, Series 2010A (Tax-exempt) with a true interest cost of 2.44% and a premium of \$469,093. Of the total par amount, \$3,595,000 was for general capital and \$3,440,000 for was public utility projects. The bonds were issued to fund various capital improvements in the City.

On April 8, 2010, the City issued \$54,350,000 in General obligation Public Improvement Bonds, Series 2010B (Taxable-Direct Pay Build America bonds) with a true interest cost of 3.92%. Of the total par amount, \$29,240,000 was for general capital and \$25,110,000 was for public utility projects. The bonds were issued to fund various capital improvements in the City.

On April 8, 2010, the City issued \$24,730,000 in General Obligation Notes, Series 2010C with a true interest cost of 2.35% with a premium of \$599,479. The notes were issued to fund the new City Courts Complex in the City.

The state limits the amount of general obligation debt the City can legally issue to ten percent of the assessed value of real property within the City. The City's outstanding debt, not all of which is applicable to the state limits, is significantly below this limit - which is currently \$768 million.

The City maintains bond ratings on general obligation debt of "A1", "AA-", and "AA-", from Moody's Investors Service, Standard & Poor's Public Finance Ratings and Fitch, Inc., respectively.

More detailed information about the City's long-term liabilities is presented in Note 5 to the basic financial statements.

ECONOMIC FACTORS

The City's unemployment rate for June 2010 was 9.3%, which compares to the national unemployment rate of 9.5% for June 2010. Per capita income as of June 30, 2008 was \$34,102, an increase of 6% over the previous year.

FINANCIAL INQUIRIES

This financial report is designed to provide our citizens, taxpayers, customers, investors and creditors with a general overview of the City's finances and to demonstrate the City's accountability for the money it receives. Questions concerning this report or requests for additional financial information should be directed to the Chief Financial Officer, 801 Crawford Street, Portsmouth, VA 23704.