

October 18, 2005

The Honorable Mayor and
Members of City Council
City of Portsmouth
Portsmouth, Virginia 23704

Dear City of Portsmouth, Virginia Citizens and Council Members:

We are pleased to present the Comprehensive Annual Financial Report of the City of Portsmouth, Virginia (the City) for the fiscal year ended June 30, 2005, in accordance with State statutes and City Code. This report was prepared by the City's Department of Finance in accordance with generally accepted accounting principles as set forth in the pronouncements of the Governmental Accounting Standards Board. In accordance with these guidelines, this Transmittal Letter is presented in four sections, as follows:

- (1) Introductory Section - which contains the City's organizational structure, this Transmittal Letter and the Government Finance Officers Association's (GFOA) Certificate of Achievement for Excellence in Financial Reporting;
- (2) Financial Section - which consists of the independent auditors' report, management's discussion and analysis, the basic financial statements, including the notes to the basic financial statements, required supplementary information and supplementary information;
- (3) Statistical Section - which is unaudited and includes selected financial and general information presented on a multi-year comparative basis; and,
- (4) Compliance Section - which is comprised of the independent auditors' reports on internal control and compliance with applicable laws and regulations as required by the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, the Schedule of Expenditures of Federal Awards with related notes and the Schedule of Findings and Questioned Costs.

Responsibility for both the accuracy of the presented data and the completeness and fairness of the presentation, including all disclosures, rests with City management. We believe the data as presented is accurate in all material respects; that it is presented in a manner designed to fairly set forth the financial position and results of operations of the City as measured by the financial activity of its various funds; and, that all disclosures necessary to enable the reader to gain the maximum understanding of the City's financial affairs have been included.

The City of Portsmouth, Virginia was established by act of the Virginia General Assembly in 1858. It is a political subdivision of the Commonwealth of Virginia operating under the council-

manager form of government. City Council consists of a mayor and six other council members. The City is not part of a county and has taxing powers subject to statewide restrictions and tax limits.

The City provides a full range of municipal services, including police and fire, sanitation, recreation and cultural activities, economic development, health and social services, street and highway maintenance, public improvements, planning and zoning, building inspections and environmental code compliance, general administrative services, education and water and sewer services.

The financial reporting entity includes all funds of the primary government (the City), as well as the component units for which the City is financially accountable. The Portsmouth School Board (School Board), the Portsmouth Parking Authority (Parking Authority), the Economic Development Authority of the City of Portsmouth (Economic Development Authority) (EDA) and the Portsmouth Port and Industrial Commission (PPIC) are included in the report as discretely presented component units in a separate column in the government-wide financial statements to emphasize that they are legally separate from the City and to differentiate their financial position and results of operations from that of the City. Each of these component units are administered by separate boards which are appointed by City Council or are elected by the general public as in the case of the School Board. Excluded are the financial statements of the Portsmouth Redevelopment and Housing Authority (PRHA). This organization is associated with the City, but is a legally separate entity which operates with considerable autonomy outside of the direct control of the Portsmouth City Council and for which the City is not financially accountable.

BOLD LEADERSHIP FOR THE FUTURE

In January of 2005, City Council adopted a vision statement focusing upon six vision components. This pledge was made by Council to ensure that the statements will become a reality of life in Portsmouth, Virginia by the year 2025:

Bold New Direction - The leadership is proactive in anticipating the ever-changing world. The City Council embraces the ways that inspire and challenge our citizens to seize opportunities of the new era. As a historical regional partner, the City engages neighboring communities to solve area challenges. Innovation and emerging technologies are used to succeed in the information and knowledge-based society. Portsmouth has become the hometown of choice and a community of international reputation.

Lifelong Learning Community - Education is the foundation of the City's social, political, and economic well-being and is the top priority of the City. Through collaborative efforts of City Council, School Board, and the private sector, Portsmouth has exceptional public and private schools. This includes learning opportunities for early childhood, primary and secondary education, higher education, vocational training, and workforce development. Its preferred educational system has made Portsmouth a top choice for employers and families.

Neighborhood Community Transformation - Portsmouth citizens are empowered to create their own quality of life, to ensure community safety, and to elevate the livability of their own neighborhoods, creating true communities of choice for the 21st century. Citizens work together with local government to fully utilize human and community assets, thus producing

a state-of-the-art environment that includes excellent schools, public facilities, parks, green spaces, gateways, and roadway corridors. Our neighborhoods have been transformed into communities that promote and celebrate diversity, equity, and the inclusiveness of all citizens.

A Robust and Prospering Economy - Portsmouth is a financially prosperous community with a superior quality of life. Residents enjoy diverse employment choices from maritime, manufacturing, medical, military, marketing, and management opportunities. Portsmouth municipal government has created an environment that has generated significant private investment resulting in job creation, expanded tax revenue, and one of the region's lowest real estate tax rates, along with an enviable bond rating.

World Class Maritime Center - As a historic waterfront city, Portsmouth is strategically located in the center of the eastern seaboard on the world's largest natural harbor at mile marker "0" on the intra-coastal waterway. The City boasts a world-class transportation system and is home to the world's largest container line and America's oldest naval shipyard. Portsmouth is the gateway to international shipping, hosting private and state operated shipping terminals with a worldwide reach. Our waterfront offers a diverse, unique mixture of recreational boating, marinas, tours, and maritime support industries.

Pride of Past, Promise of Future - Portsmouth's tomorrows are found in the footsteps of the richest traditions of America, from the earliest days of Colonial Virginia through the victories of equality, dignity, and diversity. As guardian of the collective heritage of many people, we have become one. The Portsmouth family preserves the proudest traditions of the past as the compass for our future, drawing the grace of our spirit into the nobility of what we have become. Portsmouth's rich historical diversity is celebrated throughout the year in festivals, concerts, and ceremonies. Portside, which sits at the center of our "Path of History," serves as our signature community-gathering place. Seasonal programs and entertainment punctuate the year, drawing neighbors, families, and guests from throughout the City, the region, and the world to celebrate Portsmouth's people, history, and future.

To achieve the City's vision statement by 2025, the City Council and management continue to achieve balance in the many and often competing needs within the City's available resources. The City must have policies and objectives to guide the decision-making and budget development processes. These objectives include:

- Develop a plan for eliminating reliance on Revenue Anticipation Notes (RAN's) used as a short-term borrowing tool to meet current operating cash requirements;
- Increase annual funding from the General Fund to eliminate cash flow deficits in the Risk Management and Insurance fund in future budget years;
- Achieve an undesignated fund balance target of 12.5% of General Fund revenues, with a target of 15% after the cash flow deficits in the Internal Service funds are eliminated;
- Maintain debt affordability by issuing debt with a debt outstanding to assessed value ratio cap of 5%, and General Fund - supported debt service to General Fund revenue ratio cap of 12%;
- Maintain contributions to the pension trust funds to fully fund the City's pension liability; and

- Analyze the requirements and develop a plan for converting the Public Utility General Obligation Bonds to Public Utility Revenue Bonds.

ECONOMIC CONDITION AND OUTLOOK

The growth in our tax base is a significant factor to the City's economic and fiscal health. More than 70% of General Fund revenues are provided by general property and other local taxes. The assessed value of real property rose by \$351 million, or 9.74% during 2005. The assessed value of personal property rose by \$32 million, or 5.62% during 2005. These increases reflect the current national and regional trends of increasing values. This increase in assessment values is an extremely positive indicator in evaluating Portsmouth's local economy.

Major Initiatives

As an older core city, Portsmouth has expended considerable efforts and resources to continue to revitalize itself. Since Portsmouth is surrounded by other independent cities, annexation is not possible, therefore, development and redevelopment is focused inside City limits. Consequently, the City has undertaken an asset management strategy that includes taking an inventory and analyzing the best and highest uses for the properties located within the City for potential development activities. The major development and redevelopment areas within the City are described below.

Victory Crossing

Victory Crossing is a reinvented 500-acre mixed use development centrally located within Portsmouth and the Hampton Roads region at the intersection of Victory Boulevard, Greenwood Drive and I-264. The area includes a golf course, shopping center, business park, and residential development.

Bide-A-Wee Golf Course, an 18-hole public championship golf course, underwent an \$8 million renovation in 1998 with design assistance from Curtis Strange. In 2002, Bide-A-Wee was named the "Most Improved Course" in the nation by Golf Digest. The course hosts over 40,000 rounds of golf annually.

The 450,000 square foot Victory Crossing Shopping Center opened in mid-to-late 2002 on a 51-acre site formerly occupied by an obsolete mall. It was a public-private partnership and the first major shopping center to be developed in Portsmouth in nearly 20 years. The center is anchored by Lowe's Home Improvement Warehouse and Farm Fresh. Sales in 2004 totaled over \$86 million, a 23% increase over sales in 2003, the center's first full year of operation.

Victory Crossing Business Park is one of Portsmouth's largest developable tracts of land and the site of the second planned business park in the City. The 135-acre park will host Class A and B office buildings and Tidewater Community College's (TCC's) Portsmouth Campus, a state-of-the-art center of higher education for the 21st Century. TCC is expected to open in 2008 with a projected enrollment of 16,500 students upon completion of all phases of construction. Master developer, Victory Crossing Developers LLC, is responsible for

designing, constructing and arranging financing for development of the park. Infrastructure improvements are scheduled to begin in fall 2005. Virginia Department of Transportation's improvements to Victory Boulevard, the primary corridor to the business park, are expected to begin fall 2005 and be completed in December 2006.

PortCentre Commerce Park

PortCentre Commerce Park is a 60-acre office and light industrial park located between I-264 and the Norfolk Naval Shipyard in downtown. The park, which opened in 1987 on the former US Coast Guard Base, is marketed by the Economic Development Authority.

In 1998, the EDA completed construction on a 100,000 square foot speculative office/warehouse building located in the park. The building, known as PortCentre I, was an initiative by the EDA to spur additional development in PortCentre Commerce Park. The building is now privately owned with seven tenants.

Since 2003, eight businesses have announced plans to locate in the park representing \$12.8 million in capital investment creating 315 jobs. There are two buildings planned or under construction that will create an additional 80,000 square feet of office/warehouse space. The EDA is currently working with two businesses to develop the last available site in the park.

There are 26 businesses located in the park employing over 1,000 people. Tenants include: the NBC and Fox affiliates WAVY 10/Fox 43, Neighbor Care, DACS, P&O Nedloyd, B&B Manufacturing, Premier Copper & Brass, and Wright's Engineering. Port Centre Commerce Park is also designated as a Federal Empowerment Zone, Foreign Trade Zone, and HUB Zone.

Westbury (formerly Ida Barbour)

In October 1997, Portsmouth was one of 27 cities awarded a \$24.8 million Federal Hope VI grant to revitalize Ida Barbour, a 663-unit low-income housing community located on 41 acres in the downtown area of the City. The application was submitted by the PRHA. When complete, the new \$50 million mixed-income neighborhood, Westbury, will include 278 single-family homes and rental units. The final phases consisting of 99 homeownership and 59 rental units are currently under construction. This development, to be completed by 2007 will convert the property to a taxable status and is expected to yield annual tax revenue of \$400,000 upon completion.

Cox Property

The Cox property is a 640-acre tract of industrial property with deep-water access, one of the only such tracts available on the East Coast. This property is serviced by the Western Freeway, which provides direct highway access to the region's major interstate thoroughfares.

APM Terminals

In 2004 APM Terminals announced plans to build the country's first major, privately owned shipping terminal on the Elizabeth River. The \$450 million terminal is the single largest private investment in Hampton Roads and the 8th largest in Virginia. APM Terminals purchased a 557-acre site for \$8.2 million in 2001 and has been planning the facility, securing permits, and negotiating with the City and various state organizations. Dredging began in late 2004, and construction on site is currently expected to be completed in 2007.

The following section of this letter summarizes selected financial data that directly relates to fiscal strength targets initiated by the City Council and the progress currently being made toward their achievement.

FINANCIAL INFORMATION

Education Funding

The following represents the City's history of education funding over the last five fiscal years. It should be noted that beginning in fiscal year 2002 several changes were made to the financial management arrangement between the City and the School Board. The sales and use taxes previously received by the City and transferred to the School Board is currently received directly by the School Board from the state. In addition, certain outstanding debt previously carried by the School Board is now recorded on the City's books, with the annual debt service paid directly by the City rather than transferring funds to the School Board for payment.

Fiscal Year	Operating Payments to School Board	Education Debt Service Payments	Total Education Funding	Net Increase
2005	\$ 31,352,585	2,461,526	33,814,111	2,931,017
2004	28,390,142	2,492,952	30,883,094	981,143
2003	27,379,813	2,522,138	29,901,951	1,405,726
2002	26,591,550	1,904,675	28,496,225	811,203
2001	27,685,022	-	27,685,022	1,169,369

Note: Operating payments to School Board have been adjusted to exclude sales and use taxes for 2001 for comparative purposes. The education debt service payments represent debt service payments on literary loans, 1997 taxable bonds for VRS liability refunding, VPSA bonds, and qualified zone academy bonds. Operating payments to School Board for 2001 have been adjusted to exclude a one-time transfer of \$1.3 million for comparative purposes.

General Fund Balance

The General Fund accounts for all revenues and expenditures that are not accounted for in specific purpose funds. It finances the regular day-to-day operations of the City. A strong undesignated fund balance is an indication of financial flexibility and fiscal strength. The City's undesignated fund balance rose to over 14.56% of general fund revenues in fiscal year 2005.

The following table presents the City's ratio of undesignated fund balance to general fund revenue, including operating transfers, for the last five fiscal years:

Fiscal Year	Undesignated General Fund Fund Balance	Total General Fund Revenues and Transfers	Ratio
2005	\$ 25,269,657	173,571,495	14.56%
2004	18,730,024	163,614,570	11.45%
2003	14,924,689	155,015,700	9.63%
2002	13,319,176	155,356,600	8.57%
2001	10,321,232	160,915,484	6.41%

Cash Management

The City uses a pooled cash concept to allow greater investment flexibility, and consequently, maximize its return on investment. Cash from all funds, except those restricted for specific purposes or managed by fiscal agents, is pooled for investment purposes. Cash temporarily idle during the year was invested in overnight repurchase agreements and other investments ranging from one to thirty days to maturity. The City issued Revenue Anticipation Notes (RAN's) in July 2004 in anticipation of the collection of taxes and revenues. The RAN's were paid off prior to June 30, 2005.

Additional information on the City's financial status can be found in the Management's Discussion and Analysis section of this report.

INDEPENDENT AUDIT

State law requires that the financial statements of the City be audited by a certified public accountant selected by the City Council. An annual audit of the financial records and transactions of all funds, component units, and departments of the City has been performed by Cherry, Bekaert, and Holland, L.L.P., Certified Public Accountants for the fiscal year ended June 30, 2005.

The auditors' report, which includes their opinion on the basic financial statements of the City, is contained in this report on page 1.

CERTIFICATE OF ACHIEVEMENT

The GFOA awarded a Certificate of Achievement for Excellence in Financial Reporting to the City of Portsmouth for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2004. The Certificate of Achievement is a prestigious national award that recognizes conformance with the highest standards for the preparation of a state and local government CAFR.

To be awarded a Certificate of Achievement, a governmental unit must publish an easily readable and efficiently organized comprehensive annual financial report, whose contents conform to program standards. The CAFR must satisfy both generally accepted accounting principles and applicable legal requirements.

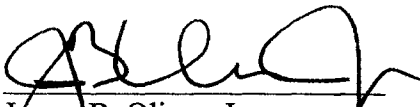
A Certificate of Achievement is valid for a period of one year. The City of Portsmouth has received a Certificate of Achievement for the last twenty-eight consecutive years (fiscal years 1977 through 2004). We believe our current CAFR continues to conform to the requirements of the Certificate of Achievement Program, therefore, we are submitting it to the GFOA.

ACKNOWLEDGMENTS

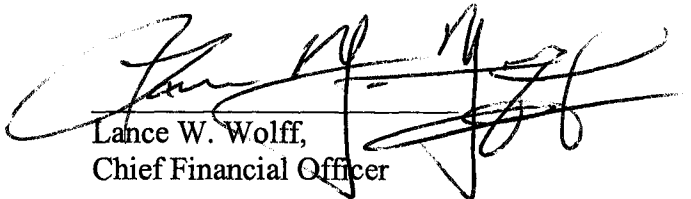
The City Council's support and cooperation in planning and conducting the financial operations of the City is acknowledged and appreciated.

We also acknowledge and extend special recognition to the City's Controller and all the staff of the Department of Finance for their efficient and dedicated service to the City. Their efforts to maintain the accounting and financial reporting system of the City of Portsmouth have led to the high quality of information being reported to the City Council and citizens of the City, as well as current and potential future investors.

Respectfully submitted,



James B. Oliver, Jr.,
City Manager



Lance W. Wolff,
Chief Financial Officer