

County of Hanover, Virginia Management's Discussion and Analysis

As management of the County, we offer readers of the financial statements this narrative overview and analysis of the financial activities of the County for the fiscal year ended June 30, 2008. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in our letter of transmittal, which can be found on pages 1-10 of this report.

Financial Highlights

- The assets of the County exceeded its liabilities at the close of fiscal year 2008 by \$309.1 million (*net assets*). Of this amount, \$75.2 million (*unrestricted net assets*) may be used to meet the County's ongoing obligations to citizens and creditors.
- The County's total net assets increased by \$23.4 million, of which the governmental activities increased by \$4.1 million and business-type activities increased by \$19.3 million.
- As of the close of fiscal year 2008, the County's governmental funds reported combined ending fund balances of \$54.9 million, a decrease of \$4.2 million from prior year. Of the \$54.9 million total, 78.5% (\$43.1 million) is available for spending at the County's discretion (*unreserved fund balance*).
- Undesignated fund balance for the General Fund was \$24.1 million, or 12.3% of total General Fund revenues, representing an increase of \$1.7 million. This exceeds the County's undesignated fund balance policy minimum, of 10% of total General Fund revenues.
- The County's total debt increased by \$438,000 (0.2%) during fiscal year 2008. The net increase was primarily the result of the issuance of \$14.6 million of VPSA general obligation bonds in November 2007 offset by principal payments of \$14.1 million. The new debt was approved with the November 2005 referendum to fund capital projects for public safety, parks and library, and schools.
- The County established a new trust fund to account for the funding of the Retiree Medical Benefits Plan that was approved by the Board of Supervisors in June, 2008. The Plan provides that the employers will provide certain subsidies toward the cost of the health benefit coverage of eligible retirees, spouses and dependents.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the County's basic financial statements. The County's basic financial statements are comprised of three components: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements.

Government-wide financial statements: The *government-wide financial statements* are designed to provide readers with a broad overview of the County's finances, in a manner similar to a private-sector business. The *statement of net assets* presents information on all of the County's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of how the financial position of the County may be changing. Increases in net assets may indicate an improved financial position; however, even decreases in net assets may reflect a changing manner in which the County may have used previously accumulated funds.

The *statement of activities* presents information showing how the County's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of related cash flows*. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

Both of the government-wide financial statements distinguish functions of the County which are principally supported by taxes, intergovernmental revenues, and other non-exchange transactions (*governmental activities*) from other activities which are intended to recover all or a significant portion of their costs primarily through user fees charged to external parties (*business-type activities*). The governmental activities of the County include general government administration; judicial administration; public safety; public works; human services; parks, recreation and cultural; community development; education; and interest on long-term debt, as well as the County's self-insurance and fleet management activities. The business-type activities consist of public utilities and the airport.

The government-wide financial statements include not only the County itself (known as the *primary government*), but also a legally separate school board and a legally separate economic development authority for which the County is financially accountable. Financial information for these *component units* is reported separately from the financial information presented for the primary government itself. The government-wide financial statements can be found on pages 32-33 of this report.

Fund financial statements: A *fund* is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The County, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the County can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

With the exception of *internal service fund* activity, (described under *Proprietary Funds*, following), **Governmental Funds** are used to account for essentially the same functions reported as *governmental activities* in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on *near-term inflows and outflows of spendable resources*, as well as on *balances of spendable resources* available at the end of the fiscal year. Such information may be useful in evaluating the County's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the County's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

The County maintains five individual governmental funds. Information is presented separately in the governmental funds balance sheet and in the governmental funds statement of revenues, expenditures, and changes in fund balances for the General Fund, the County Improvements Fund and the School Improvements Fund; all three of which are considered to be *major funds*. Data from the other two County funds, the Comprehensive Services Fund and the Community Services Fund, are combined into a single, aggregated presentation. Individual fund data for each of these *nonmajor* governmental funds is provided in the form of *combining statements* elsewhere in this report. The County adopts an annual appropriated General Fund budget, for which a budgetary comparison statement has been provided to demonstrate

compliance with this budget. The basic governmental fund financial statements can be found on pages 34-37 of this report.

The County maintains two different types of **Proprietary Funds**: enterprise and internal service. *Enterprise funds* are used to report the same functions presented as *business-type activities* in the government-wide financial statements. The County uses enterprise funds to account for its public utilities fund and its airport fund (a nonmajor fund). *Internal service funds* are an accounting device used to accumulate and allocate costs internally among the County's various functions. The County uses internal service funds to account for its fleet management and its healthcare and other postemployment benefit self-insurance activities. Because both of these services predominantly benefit governmental rather than business-type functions, they have been included within *governmental activities* in the government-wide financial statements.

Proprietary funds provide the same type of information as the business-type activities in the government-wide financial statements, only in more detail. Conversely, both internal service funds are combined into a single, aggregated presentation in the proprietary fund financial statements. Individual fund data for the internal service funds is provided in the form of combining statements elsewhere in this report. The basic proprietary fund financial statements can be found on pages 38-40 of this report.

Fiduciary funds are used to account for resources received and held in a fiduciary capacity for the benefit of individuals, private organizations, or other governments. Fiduciary funds are *not* reflected in the government-wide financial statement because the resources of those funds are *not* available to support the County's own programs. However, the County is responsible for ensuring that fiduciary fund assets are used for their intended purposes. The County's fiduciary funds consist of an employee benefit trust fund, the Retiree Medical Benefits Trust Fund, and Agency Funds. The Retiree Medical Benefits Trust Fund is used to account for the receipt and disbursement of employer contributions and assets held in trust to provide healthcare benefits to retirees, and agency funds are used to report resources held in a purely custodial capacity for individuals, private organizations or other governments. The fiduciary fund financial statements can be found on pages 41-42 of this report, while individual fund data for the agency funds can be found in the form of combining statements elsewhere in this report.

Notes to the financial statements: The notes provide additional information that is essential for a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 43-75 of this report.

Other information: In addition to the basic financial statements and accompanying notes, this report also presents certain *required supplementary information* concerning the County's progress in funding its obligations to provide pension and other postemployment benefits to its current and future retirees. This required supplementary information can be found on page 77 of this report.

The combining statements referred to earlier in connection with nonmajor governmental funds, internal service funds and agency funds, and individual fund statements and schedules are presented immediately following the required supplementary information, starting on page 79 of this report.

This report also contains a statistical section that supplements the basic financial statements by presenting detailed trend information, to assist the users to assess the economic condition of the County. We encourage our readers to review the statistical section, to better understand the County's operations, services and financial condition.

Government-wide Financial Analysis

As noted earlier, over time, changes in net assets may serve as a useful indicator of a County's financial position. Of interest, the County's assets exceeded liabilities by \$309.1 million at the close of fiscal year 2008. By far the largest portion of the County's net assets (\$219.6 million, 71.1% of total) reflects its investment in capital assets (e.g., land, buildings, machinery, and equipment); less any related debt used to acquire those assets that is still outstanding. The County uses these capital assets to provide services to citizens, like water and wastewater services, schools, libraries, law enforcement, and fire and emergency medical services. Consequently, these assets are *not* available for future spending. Although the County's net assets invested in 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 (i.e., the County's investment in capital assets is of a long-term nature, as assets acquired are generally not sold or otherwise disposed of during their useful life).

An additional portion of the County's net assets (\$14.2 million, 4.6% of total) represents resources that are subject to external restrictions on how they may be used, including amounts restricted for capital projects, grant programs, debt covenants and postemployment healthcare benefits. The remaining balance of unrestricted net assets (\$75.2 million, 24.3% of total) may be used to meet the County's ongoing obligations to citizens and creditors.

At the end of fiscal year 2008, the County is able to report positive balances in all three categories of net assets, both for the primary government as a whole, as well as for its separate governmental and business-type activities. As noted previously, the County's net assets increased by \$23.4 million during fiscal year 2008. The \$4.1 million increase in the net assets of governmental activities resulted primarily from a combination of an 9.6% growth in general property tax revenue; an education surplus of \$2.4 million (of which \$1.5 million has been earmarked as a funding source for the fiscal year 2009 School Improvements Fund budget and an additional \$500,000 has been designated for future School capital improvements); and the impact of the County's strong debt principal retirement practices. The \$19.3 million increase in net assets of business-type activities includes \$8.1 million of donated capital assets accepted by the public utility system, and recognition of a \$5.8 million combined water and wastewater capacity fee received from Caroline County for water and wastewater capacity for the future Virginia State Fair location. The remaining increase in utility fund net assets resulted primarily from the receipt of \$4.9 million of additional nonoperating capacity fees, which helps to offset the cost of existing utility capital improvements.

The following tables summarize the County's Statement of Net Assets and Statement of Activities:

Summary of Net Assets

| | Governmental Activities | | Business-type Activities | | Total | |
|-------------------------------------------------|----------------------------|--------------------|-----------------------------|--------------------|--------------------|--------------------|
| | 2008 | 2007 | 2008 | 2007 | 2008 | 2007 |
| | Current and other assets | \$ 122,477,345 | 119,149,317 | 39,812,437 | 32,187,833 | 162,289,782 |
| Capital assets | 211,183,264 | 200,885,039 | 194,630,705 | 184,642,235 | 405,813,969 | 385,527,274 |
| Total assets | <u>333,660,609</u> | <u>320,034,356</u> | <u>234,443,142</u> | <u>216,830,068</u> | <u>568,103,751</u> | <u>536,864,424</u> |
| Long-term liabilities outstanding | 154,926,320 | 152,458,301 | 40,792,206 | 42,205,475 | 195,718,526 | 194,663,776 |
| Other liabilities | 61,434,369 | 54,408,138 | 1,894,657 | 2,191,625 | 63,329,026 | 56,599,763 |
| Total liabilities | <u>216,360,689</u> | <u>206,866,439</u> | <u>42,686,863</u> | <u>44,397,100</u> | <u>259,047,552</u> | <u>251,263,539</u> |
| Net assets (as restated): | | | | | | |
| Invested in capital assets, net of related debt | 65,019,988 | 61,976,094 | 154,625,394 | 144,494,562 | 219,645,382 | 206,470,656 |
| Restricted | 10,833,093 | 9,599,544 | 3,374,603 | 3,445,443 | 14,207,696 | 13,044,987 |
| Unrestricted | 41,446,839 | 41,592,279 | 33,756,282 | 24,492,963 | 75,203,121 | 66,085,242 |
| Total net assets | <u>\$ 117,299,920</u> | <u>113,167,917</u> | <u>191,756,279</u> | <u>172,432,968</u> | <u>309,056,199</u> | <u>285,600,885</u> |

Summary of Activities

| | Governmental Activities | | Business-type Activities | | Total | |
|-----------------------------------------|----------------------------|--------------------|-----------------------------|--------------------|--------------------|--------------------|
| | 2008 | 2007 | 2008 | 2007 | 2008 | 2007 |
| | Revenues: | | | | | |
| Program revenues: | | | | | | |
| Charges for services | \$ 12,769,851 | 13,833,301 | 21,374,791 | 19,618,120 | 34,144,642 | 33,451,421 |
| Operating grants and contributions | 16,589,245 | 15,408,252 | - | - | 16,589,245 | 15,408,252 |
| Capital grants and contributions | 9,696,499 | 5,902,858 | 20,831,594 | 10,776,808 | 30,528,093 | 16,679,666 |
| General revenues: | | | | | | |
| Property taxes | 128,411,615 | 117,152,314 | - | - | 128,411,615 | 117,152,314 |
| Other taxes | 29,953,699 | 27,952,788 | - | - | 29,953,699 | 27,952,788 |
| Noncategorical State aid | 15,419,398 | 14,895,053 | - | - | 15,419,398 | 14,895,053 |
| Grants and contributions | 1,119,078 | 849,714 | - | - | 1,119,078 | 849,714 |
| Other | 1,967,295 | 1,790,177 | 1,337,243 | 1,015,229 | 3,304,538 | 2,805,406 |
| Total revenues | <u>215,926,680</u> | <u>197,784,457</u> | <u>43,543,628</u> | <u>31,410,157</u> | <u>259,470,308</u> | <u>229,194,614</u> |
| Expenses: | | | | | | |
| General government | 14,671,166 | 13,312,730 | - | - | 14,671,166 | 13,312,730 |
| Judicial administration | 4,385,408 | 3,930,945 | - | - | 4,385,408 | 3,930,945 |
| Public safety | 43,545,081 | 39,333,719 | - | - | 43,545,081 | 39,333,719 |
| Public works | 12,431,287 | 8,741,705 | - | - | 12,431,287 | 8,741,705 |
| Human services | 23,096,023 | 21,269,844 | - | - | 23,096,023 | 21,269,844 |
| Parks, recreation and cultural | 6,413,393 | 4,732,962 | - | - | 6,413,393 | 4,732,962 |
| Community development | 5,593,695 | 5,306,364 | - | - | 5,593,695 | 5,306,364 |
| Education | 100,925,769 | 81,203,331 | - | - | 100,925,769 | 81,203,331 |
| Interest on long-term debt | 503,177 | 627,078 | - | - | 503,177 | 627,078 |
| Public utilities | - | - | 23,823,738 | 22,688,647 | 23,823,738 | 22,688,647 |
| Airport | - | - | 626,257 | 465,203 | 626,257 | 465,203 |
| Total expenses | <u>211,564,999</u> | <u>178,458,678</u> | <u>24,449,995</u> | <u>23,153,850</u> | <u>236,014,994</u> | <u>201,612,528</u> |
| Increase in net assets before transfers | 4,361,681 | 19,325,779 | 19,093,633 | 8,256,307 | 23,455,314 | 27,582,086 |
| Transfers | (229,678) | (619,072) | 229,678 | 619,072 | - | - |
| Increase in net assets | <u>4,132,003</u> | <u>18,706,707</u> | <u>19,323,311</u> | <u>8,875,379</u> | <u>23,455,314</u> | <u>27,582,086</u> |
| Net assets - beginning of year | 113,167,917 | 94,461,210 | 172,432,968 | 163,557,589 | 285,600,885 | 258,018,799 |
| Net assets - end of year | <u>\$ 117,299,920</u> | <u>113,167,917</u> | <u>191,756,279</u> | <u>172,432,968</u> | <u>309,056,199</u> | <u>285,600,885</u> |

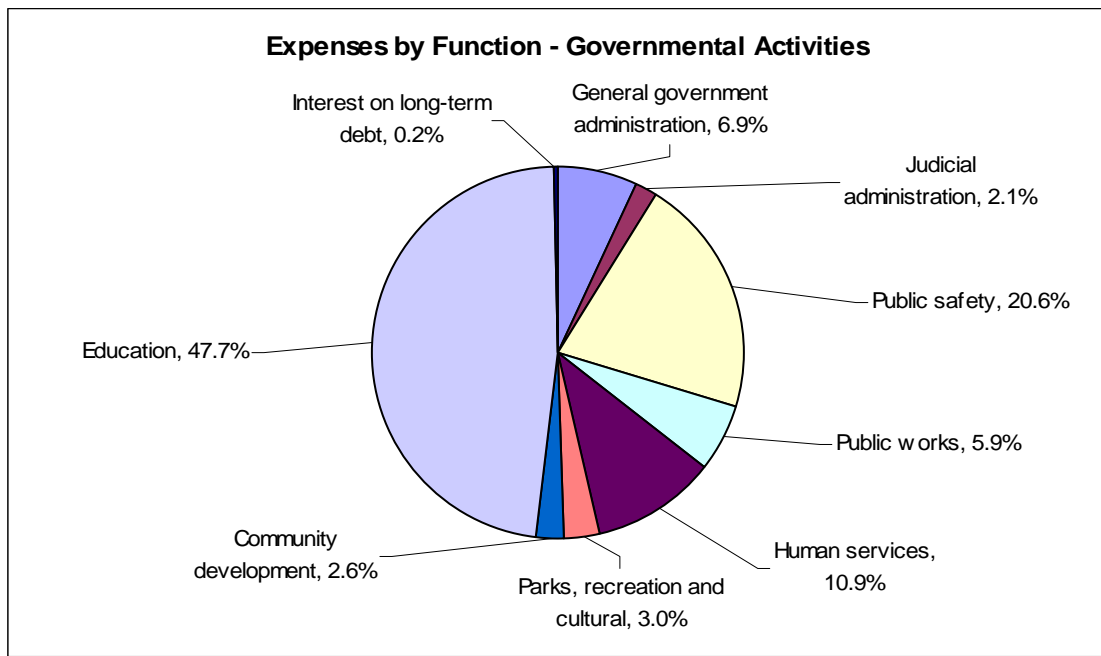
As noted previously, the increase in net assets attributable to the County's **governmental activities** totaled \$4.1 million for fiscal year 2008. Generally, net asset changes are the result of the difference between revenues and expenses. Fiscal year 2008 revenues of \$215.7 million represent an increase of \$18.5 million or 9.4% over the prior year, while expenses of \$211.6 million represent an increase of \$33.1 million or 18.6% compared to the prior year. A summary of key elements follows:

- General property taxes collections were \$128.4 million, representing an increase of \$11.3 million or 9.6%. The increase was primarily due to the continued growth in the tax base from new residential and commercial construction of 2.4%, and reassessment of existing real property of 7.2%. The personal property tax revenue grew \$1.9 million, or 8.6%, primarily due to growth in business property. The State remittance for personal property tax totaled \$15.0 million and will remain at this amount indefinitely.
- Charges for services decreased by \$1.1 million to \$12.8 million. This 7.7% decrease is primarily the result of the January 1, 2007 implementation of the State's new telecommunications use tax, which replaced the consumer utility tax for telecommunications, E911 and cable television. Previous to January 1, 2007, these taxes had been reported as charges for services, which has resulted in a decrease in reported charges for services revenue in fiscal year 2008. Beginning January 1, 2007, and during all of fiscal year 2008, the telecommunications use tax has been reported in utility taxes, a general revenue.
- Operating grants and contributions totaled \$16.6 million, an increase of \$1.1 million, or 7.7%. Significant portions of this increase resulted from increases in state grants and contributions to the Comprehensive Services Fund, and the Community Services Fund of \$222,000 and \$139,000, respectively, and an increase of \$223,000 in Fire/EMS' federal SAFER grant.
- Capital grants and contributions totaled \$9.7 million as compared to \$5.9 million in fiscal year 2007, a 64.3% increase. The increase includes \$1.8 million recognized pursuant to a frequency reconfiguration agreement with Sprint/Nextel, \$1.9 million of revenue from developers for capital road projects, \$1.6 million of state categorical aid for capital road projects, and \$754,000 of proffer collections. Capital grants and developer contributions vary by year based upon capital project construction activity.
- Of the 18.6% increase in governmental activities expenses, 5.4% resulted from decreased cost recoveries corresponding to completion of School Board capital projects, another 4% is attributable to the employee merit pay increase, 2% is due to new road projects, 1% was due to increased healthcare benefit costs, with the remaining 5.7% attributable to other operating and capital outlay costs, primarily in the priority areas of education and public safety, as further described by function below.
- Expenses for general governmental administration increased \$1.4 million, or 10.2%. In addition to the applicable factors described above, this increase included funding for technology infrastructure, a new customer service agent position for the Commissioner of Revenue office, and a new senior system engineer position in information technology.
- Expenses for public safety increased \$4.2 million, or 10.7%. Public safety is a priority of the Board of Supervisors. In addition to the applicable factors described above, this increase included a full fiscal year of salary for twelve new Fire/EMS positions funded by the federal SAFER grant award received in fiscal year 2007, additional salaries for a lieutenant position and new part-time positions in Fire/EMS, eight new Sheriff's office positions, one emergency communications position, and one animal control kennel attendant supervisor position, new equipment and technology enhancements.
- Expenses for public works increased \$3.7 million, or 42.2%. This increase includes \$3.5 million increase in capital projects and primarily is the result of the North Lakeridge Parkway South

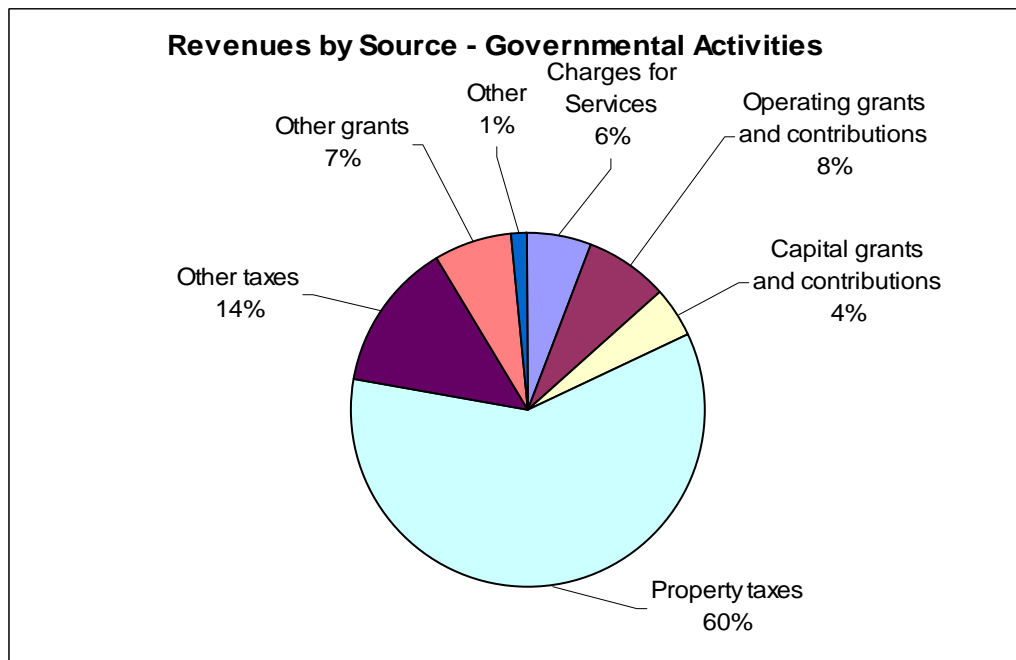
Extension road capital project. The County does not retain title to nor capitalize road projects, and Public Works expenses vary by year based upon road construction activity.

- Expenses for human services increased \$1.8 million, or 8.6%. In addition to the applicable factors described on the previous page, this increase includes a \$460,000 increase in mandated expenses in the Comprehensive Services Fund (offset by a \$222,000 increase in State funding), a \$344,000 increase in tax relief for the elderly, and an increase in expenses in the Community Services Fund of \$180,000. The Community Services Fund provides mental health and mental retardation services to the citizens of the County.
- Parks, recreation and cultural expenses increased \$1.7 million, or 35.5%. The increase includes an increase in program expense which is offset by an increase in program fees, an increase in the volume of programs, and additional grounds and other small equipment purchases.
- The local share of expenditures for education of \$100.9 million increased by \$19.7 million, or 24.3%, from the prior year. \$10.1 million or 51% of the increase was primarily due to increased School Board instruction and support services costs, including funding for 31.5 new full-time equivalent positions, a 4% pay adjustment and increased healthcare benefit and other operating costs. The other \$9.6 million or 49% of the increase resulted primarily from a reduction in capital cost recoveries recognized in fiscal 2008 from the School Board. Under Virginia's *Tenancy in Common* (page 58), the County recognizes a capital cost recovery as an increase or decrease to educational expense, equal to the change in expended School's on-behalf debt outstanding at the end of each fiscal year. The County recognized capital cost recoveries corresponding to completion of School Board capital projects of \$3.2 and \$12.9 million during fiscal 2008 and 2007, respectively, resulting in a comparative increase of \$9.6 million in education expense during fiscal 2008.

The following graph illustrates the County's fiscal year 2008 expenses for each functional area comprising its governmental activities. Education expense represents the County's payment to its School Component Unit on the accrual basis.



The following graph illustrates the County's fiscal year 2008 governmental revenues by source as a percentage of the total.



The increase in the net assets attributable to the County's **business-type activities** totaled \$19.3 million for fiscal year 2008. Similar to changes in net assets attributable to governmental activities, changes in business-type activity net assets also result from the difference between revenues and expenses. However, unlike governmental activities, which rely primarily on general tax revenues to finance operations, business-type activities are financed to a significant extent by fees charged to external parties for goods and services provided. The County's business-type activities consist of its water and wastewater treatment services and capital activities, provided by its Public Utility Fund and airport operating and capital activities included in the Airport Fund.

Like all business-type activities, the County's Public Utilities Fund attempts to recover as much as possible of the operating expenses it incurs to meet service demands through user charges. Nevertheless, Public Utilities operating revenues were less than its operating expenses for fiscal year 2008, resulting in a net operating loss of \$987,000, primarily due to continued moderate growth of 1.4% in the Suburban Service Area. Even with the operating loss, Public Utilities' net assets increased by \$18.8 million during fiscal year 2008, primarily due to non-operating capacity fees received of \$11.2 million, and \$8.1 million of donated assets. A summary of relevant fiscal year 2008 financial results follows:

The Department of Public Utilities implemented user fee increases of 6% for water and 5% for wastewater in fiscal year 2008. The methodology of the 2005 rate study aligns the cost for provision of water and sewer services to the appropriate user fee (charges for services) and calculates the value of a connection to the system (capacity fees) based upon the cost of current and future infrastructure. Other revenue and expense changes are detailed below.

- Charges for services totaled \$21.0 million, which were \$1.8 million (9.1%) higher than fiscal year 2007. This increase was primarily due to the user fee increases and record demand for water during a seasonal draught.

- Nonoperating capacity fees totaled \$11.2 million, which were \$7.2 million (184.4%) higher than fiscal year 2007. The increase was primarily due to a combined water and wastewater capacity fee payment of \$5.8 million from Caroline County for the future Virginia State Fair location to be served by Hanover Public Utilities. Capital contributions totaled \$8.1 million, and resulted from the construction of water and sewer lines by developers as part of residential and commercial development.
- Operating expenses totaled \$22.3 million, which were \$1.2 million (5.7%) higher than fiscal year 2007. The increase in expenses was primarily due to the general inflation rate, increased depreciation expense, and higher costs for water purchased from the City of Richmond and Henrico County due to higher demand.

The Airport Fund recognizes operating and capital expenses of the Hanover County Municipal Airport. The airport is a 210-acre facility located within the County's major industrial park near the intersection of I-95 and I-295. It is a general aviation reliever airport for the Richmond International Airport. The airport facilities are currently leased to a fixed base operator under a Lease and Management Agreement. This fund recognizes lease revenue from the fixed base operator and debt service expense associated with revenue bonds that were issued in fiscal year 2007 to construct hangars. In addition to the lease revenues and debt service expense, this fund also recognizes the operating cost of one airport manager position, depreciation expense, and grant revenues received for airport capital improvement projects. The Airport Fund recognized an operating loss of \$489,000 and a positive change in net assets of \$529,000 for fiscal year 2008. The increase in net assets was primarily the result of intergovernmental revenues recognized in the amount of \$860,000, which funded airport capital projects.

Financial Analysis of the County's Funds

As noted earlier, the County uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental funds: The focus of the County's *governmental funds* is to provide information on near-term inflows, outflows, and balances of *spendable* resources. Such information is useful in assessing the County's financing requirements. In particular, *unreserved fund balance* may serve as a useful measure of the County's net resources available for spending at the end of the fiscal year.

As of the end of fiscal year 2008, the County's governmental funds reported combined ending fund balances of \$54.9 million, a decrease of \$4.2 million in comparison with fiscal year 2007. Of the \$54.9 million, 78.5% (\$43.1 million) constitutes unreserved fund balance, which is available for spending at the County's discretion. The unreserved fund balance includes \$20.4 million designated as described in footnote V. B. on page 64. Fund balance of \$11.8 million is *reserved* to indicate that it is not available for new spending because it has already been committed to (1) liquidate contracts and purchase orders of the prior fiscal year for which funding has been received (\$11.0 million, including grant programs), (2) provide required debt reserves (\$770,000), and (3) establish a reserve for inventory (\$29,100).

The General Fund is the primary operating fund of the County. The fund balance of the County's General Fund increased \$1.3 million during fiscal year 2008. At the end of fiscal year 2008, unreserved fund balance of the General Fund was \$36.6 million, while total fund balance reached \$37.5 million. The increase in fund balance was primarily the result of higher than anticipated general property taxes and investment earnings, and lower than anticipated public safety and education expenditures. \$9.9 million of the General Fund's fiscal 2008 ending fund balance has been designated as a source of funding of the fiscal year 2009 budget. Of interest, as one measure of the General Fund's liquidity, it is useful to compare fund balances to total fund revenues. The General Fund's unreserved fund balance represents

18.6% of total General Fund revenues, while its total fund balance represents 19.0% of that same amount. Of General Fund unreserved fund balances, the \$24.1 million undesignated portion represents 12.3% of total General Fund revenues, and exceeds the 10% minimum set by the County's fund balance policy.

The fund balance in the County Improvements Fund decreased by \$1.2 million during fiscal year 2008 as a result of various fiscal year 2008 capital project expenditures, for which the source of funding consisted of prior fiscal year-end fund balances designated for County capital improvements. The unreserved fund balance is \$8.1 million and the reserved fund balance is \$10.2 million. The unreserved, designated fund balance totaled \$8.0 million, as described in footnote V.B. on page 64. The undesignated fund balance of \$104,079 is a decrease of \$288,512, and is primarily the result of the use of undesignated fund balance to offset certain revenue receipts which were below budget.

The fund balance of the School Improvements Fund decreased \$4.1 million during fiscal year 2008, primarily due to 2005 referendum project expenditures made prior to the issuance of the general obligation bonds, in the amount of \$3.5 million. The deficit in the School Improvements Fund unreserved fund balance of \$2.1 million resulted from this timing difference, and will be funded by proceeds from the next 2005 referendum bond issuance.

Proprietary funds: The County's proprietary funds financial statements provide the same type of information presented in the business-type activities on the government-wide financial statements, but in more detail. Public Utilities' total net assets increased \$18.8 million, or 11.6% during fiscal year 2008. The majority of the increase was due to a \$5.8 million water and wastewater capacity fee payment from Caroline County, and \$8.1 million of capital assets contributed by developers of residential and commercial water and wastewater construction projects. Public Utilities' net assets restricted for debt covenants decreased by \$89,000, and its unrestricted net assets increased \$9.4 million. The Airport Fund net assets increased by \$529,000 in fiscal year 2008. A summary of proprietary fund operations for the year was previously provided in the discussion of business-type activities.

General Fund Budgetary Highlights

General Fund budget amendments resulted in an increase of \$3.2 million between the originally-adopted fiscal year 2008 budget and the final budget, with \$1.5 million of the increase resulting from reappropriation of fiscal year 2007 year-end encumbered and unencumbered fund balance amounts, for completion of ongoing projects in fiscal year 2008. Significant reappropriations included:

- \$190,000 for the Sheriff's Office, repair of the firing range;
- \$151,000 for the Clerk of the Circuit Court, consisting of grant funding for labor and supplies for microfilming and web access initiatives;
- \$118,000 for the Parks and Recreation Department, primarily for an anticipated refund of previously encumbered grant funds to the Federal Emergency Management Agency, which were not required for Tropical Storm Gaston recovery capital projects;

The remaining \$1.7 million in budget amendments were funded by various revenue sources. Significant amendments included:

- \$900,000 transfer from the General Fund to the School Improvements Fund, of prior year fund balances designated for capital improvements;

- \$200,000 transfer to recognize State revenue from the Governor’s Opportunity Fund for an economic development project;
- \$192,000 increase in Tax Relief for the Elderly to recognize the impact of enhancements to the program approved by the Board of Supervisors in October, 2007;
- \$169,000 for the Fire/EMS Department, to recognize the award of State grants for equipment and training;
- \$79,000 for the Clerk of the Circuit Court to recognize additional revenue from the State Compensation Board for the microfilming and web access initiatives.

Capital Assets and Debt Administration

Capital assets: The County’s investment in governmental and business-type activity capital assets as of June 30, 2008, totals \$405.8 million, net of accumulated depreciation. This represents an increase of \$20.3 million, or 5.3% over fiscal year 2007. The investment in capital assets includes land, buildings, improvements, infrastructure (primarily stormwater drainage basins), machinery and equipment and construction in progress. State law grants the County a *tenancy in common* with the School Component Unit for School capital assets for which the County incurs an obligation payable over more than one fiscal year, under which the County reported net capital assets of \$129.7 million at year-end. Major capital asset events during fiscal year 2008 included the following:

- Governmental activities capital assets increased \$10.3 million, net of accumulated depreciation. Construction in progress includes the addition of \$3.7 million for a new emergency communications building, \$1.7 million for the Mechanicsville Library, \$1.0 million in new parks projects, and \$900,000 for two new fire stations.
- Business-type activity capital assets increased \$10.0 million, net of accumulated depreciation, of which \$8.0 million consisted of completed and in-progress water and wastewater infrastructure projects reported in the Public Utilities Fund, and \$2.0 million consisted of capital improvements reported in the Airport Fund.

Additional information on the County’s capital assets can be found in note IV. C., on pages 56-58 of this report. Capital assets net of accumulated depreciation are illustrated in the following table:

| | Governmental <u>Activities</u> | Business-type <u>Activities</u> | 2008 <u>Total</u> | 2007 <u>Total</u> |
|-----------------------------------|-----------------------------------|------------------------------------|----------------------|----------------------|
| Land | \$ 8,601,076 | 10,201,876 | 18,802,952 | 18,515,577 |
| Buildings | 162,475,289 | 61,304,550 | 223,779,839 | 220,152,171 |
| Improvements other than buildings | 3,030,556 | 116,172,246 | 119,202,802 | 111,383,068 |
| Machinery and equipment | 11,310,381 | 1,013,105 | 12,323,486 | 12,715,716 |
| Infrastructure | 14,057,957 | - | 14,057,957 | 13,536,624 |
| Construction in progress | <u>11,708,005</u> | <u>5,938,928</u> | <u>17,646,933</u> | <u>9,224,118</u> |
| Total | <u>\$ 211,183,264</u> | <u>194,630,705</u> | <u>405,813,969</u> | <u>385,527,274</u> |

Long-term debt: At the end of fiscal year 2008, the County had total bonded debt outstanding of \$186.1 million. Of this amount, \$144.5 million comprises debt backed by the full faith and credit of the County. The remainder of the County’s debt represents bonds secured solely by specified revenue sources (i.e., revenue bonds and obligations under capital leases). The County’s total debt increased during fiscal year 2008 by \$438,000 (0.2%). The net increase was primarily a result of a \$14.6 million Virginia Public School Authority issuance for School capital projects in November 2007, less principal payments. The County is in compliance with all debt policy and debt coverage requirements as illustrated on pages 120-121, 126 and 128 of the Statistical Section of this report.

In the Commonwealth of Virginia, there is no State statute that limits the amount of general obligation debt a County may issue. Additional information on the County’s long-term debt can be found in note IV. E., on pages 59-63 of this report. The following table illustrates the County’s outstanding debt at June 30, 2008:

| | Governmental Activities | Business-type Activities | Total |
|---------------------------|----------------------------|-----------------------------|--------------------|
| General obligation bonds | \$ 144,498,064 | - | 144,498,064 |
| Revenue bonds | - | 38,906,488 | 38,906,488 |
| Capital lease obligations | 2,739,169 | - | 2,739,169 |
| Total | <u>\$ 147,237,233</u> | <u>38,906,488</u> | <u>186,143,721</u> |

Economic Factors and Next Year’s Budgets and Rates

The unemployment rate for the County in August, 2008 was 4.1%, which was 1.5% higher than a year ago. Unemployment is currently rising throughout the nation, and this rate continues to compare favorably to the State’s average unemployment rate of 4.6% and the national average rate of 6.1% for the same period. The County is not experiencing an overall devaluation of property values, although there are some pockets of lower values. Initial assessment data suggest an overall slight increase in property values for tax year 2009. Lower personal property values are anticipated in fiscal year 2010, due to increased depreciation of vehicles and lower new vehicle purchases in 2008. Fiscal year 2009 revenue estimates appear, in total, to be on target with budget.

The County recognizes the value of properly illustrating year-end commitments. Accordingly, at June 30, 2008, the County has designated \$9.9 million of unreserved fund balance in its General Fund to fund a portion of the fiscal year 2009 adopted General Fund budget, which includes \$5.9 million for one-time capital funding. Also at June 30, 2008, the County designated an additional \$500,000 of fund balance in its General Fund for future School capital improvements. All fund balance designations at June 30th are illustrated in footnote V-B on page 64 of this report. In this manner, the County is able to utilize all or portions of surpluses at the end of the current fiscal year as a source of funding in a subsequent year, while also meeting the County’s fund balance policy and maintaining desired reserves for future needs.

In April, 2008, the Board of Supervisors approved moving the December 5th due date for real and personal property taxes away from the holiday season. Real property taxes are now due in two halves (existing June 5th, and new October 5th), and personal property tax is now due February 5th of the subsequent year. All County general property tax rates remained unchanged for calendar year 2008. In fiscal year 2008, Public Utilities’ user fee increases include a 6.0% rate increase for water, a 5.0% increase for sewer, and a 4.0% rate increase for capacity fees.

The fiscal year 2009 budget includes the County's share of the State's reduction of \$50.0 million per year in aid to localities. The State allowed localities to elect from three options which included (1) reducing one State aid program, (2) reducing multiple State aid programs on a proportional basis, or (3) making a reimbursement to the State in aggregate for the County's share. The County chose to make the reimbursement of its share (\$366,000) for fiscal year 2009. The County's Five-Year Financial Plan includes the State's fiscal year 2010 reduction.

Requests for Information

This financial report is designed to provide a general overview of the County's finances for all those with an interest in the County's finances. Questions concerning any of the information provided in this report, or requests for additional financial information should be addressed to the Director of Finance, County of Hanover, P.O. Box 470, Hanover, VA 23069.