

JAMES CITY SERVICE AUTHORITY
(A Component Unit of the County of James City, Virginia)

Management's Discussion and Analysis

June 30, 2005 and 2004

This section of the James City Service Authority's (the Authority or JCSA) annual financial report presents our discussion and analysis of the Authority's financial performance during fiscal years ended June 30, 2005 and 2004.

Financial Highlights for Fiscal Years 2005 and 2004

- * The Authority's total net assets were \$139.8 million at June 30, 2005, which represents a 6.5% increase from 2004. Total net assets at June 30, 2004 were \$131.4 million.
- * The Authority's total operating expenses before depreciation and amortization increased by 8.6% in 2005 from 2004, and total operating revenues increased by 9.1% in 2005 from 2004. Total operating expenses before depreciation and amortization increased by 8.2% in 2004 from 2003, and total operating revenues increased by 9.7% in 2004 from 2003.
- * Capital assets increased by 5.3% in 2005 from 2004. This was primarily due to completion of the groundwater treatment facility and the First Colony waterline replacement. In September 2003, the Authority experienced effects from Hurricane Isabel. Costs related to this storm totaled \$209,444. Revenue was received from insurance and FEMA to offset these costs.

Overview of the Financial Statements

The financial section of this report has two components—Management's Discussion and Analysis (this section) and the basic financial statements. The basic financial statements are comprised of the balance sheets, statements of revenues, expenses and changes in net assets, statements of cash flows and notes to the basic financial statements.

Transactions are accounted for under the economic resources measurement focus and the accrual basis of accounting similar to an enterprise fund. Accordingly, revenues are recognized in the period earned and expenses are recognized when they are incurred. Enterprise funds are used to account for activities that are financed and operated similar to those often found in the private sector.

Financial Analysis

The difference between assets and liabilities, net assets, is one way to measure financial health or financial position. Over time, increases and decreases in net assets are one indicator of whether the Authority's financial health is improving or deteriorating. However, you will need to also consider other non-financial factors, such as changes in economic conditions, population and service area growth, and new or changed legislation.

The Authority's net assets increased from last year by \$8.5 million. This increase is primarily related to the contribution of water and sewer systems to the Authority. The Authority's net assets increased by \$7.4 million in 2004 from 2003. This increase is primarily related to the contribution of water and sewer systems to the Authority.

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Condensed Balance Sheet Information at June 30

	2005	2004	2003	2005 vs. 2004	
				\$ Change	% Change
Capital assets	\$ 125,929,218	119,563,991	104,224,338	6,365,227	5.3%
Current and other assets	29,867,110	29,268,942	38,513,373	598,168	2.0%
Total assets	\$ 155,796,328	148,832,933	142,737,711	6,963,395	4.7%
Current liabilities	\$ 2,739,516	3,381,193	3,865,005	(641,677)	-19.0%
Long-term liabilities	13,211,343	14,092,467	14,958,591	(881,124)	-6.3%
Total liabilities	15,950,859	17,473,660	18,823,596	(1,522,801)	-8.7%
Net assets:					
Invested in capital assets, net of related debt	112,013,177	104,781,826	88,966,049	7,231,351	6.9%
Restricted for capital projects	696,483	3,155,428	15,048,381	(2,458,945)	-77.9%
Unrestricted	27,135,809	23,422,019	19,899,685	3,713,790	15.9%
Total net assets	139,845,469	131,359,273	123,914,115	8,486,196	6.5%
	\$ 155,796,328	148,832,933	142,737,711	6,963,395	4.7%

The change in net assets can also be determined by reviewing the following condensed statements of revenues, expenses and changes in net assets information.

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Condensed Statements of Revenues, Expenses and Changes in Net Assets Information
Years ended June 30

	2005	2004	2003	2005 vs. 2004	
				\$ Change	% Change
Water and sewer services	\$ 8,383,600	8,027,991	7,596,532	355,609	4.4%
Miscellaneous	1,262,416	442,554	460,601	819,862	185.3%
Reimbursement for storm costs	—	371,538	—	(371,538)	100.0%
Water and sewer facility fees	6,130,640	4,914,512	4,030,744	1,216,128	24.7%
Nonoperating revenues	531,063	186,082	302,872	344,981	185.4%
Total revenues	16,307,719	13,942,677	12,390,749	2,365,042	17.0%
Salaries	754,182	687,155	607,509	67,027	9.8%
Fringe benefits	270,864	229,833	137,091	41,031	17.9%
Operating supplies	480,994	271,026	265,937	209,968	77.5%
Maintenance of buildings and equipment	856,296	690,678	714,515	165,618	24.0%
Special services	4,292,880	4,212,422	3,860,843	80,458	1.9%
Utilities	592,153	431,373	430,235	160,780	37.3%
Water purchases	394,426	341,726	441,101	52,700	15.4%
Storm costs	—	209,444	—	(209,444)	100.0%
Other	101,570	54,965	130,420	46,605	84.8%
Depreciation and amortization	4,547,931	4,119,963	3,856,524	427,968	10.4%
Nonoperating expenses	513,617	482,695	178,843	30,922	6.4%
Total expenses	12,804,913	11,731,280	10,623,018	1,073,633	9.2%
Excess of revenues over expenses	3,502,806	2,211,397	1,767,731	1,291,409	58.4%
Capital contributions	4,983,390	5,233,761	5,696,575	(250,371)	-4.8%
Change in net assets	8,486,196	7,445,158	7,464,306	1,041,038	14.0%
Net assets at beginning of year	131,359,273	123,914,115	116,449,809	7,445,158	6.0%
Net assets at end of year	\$ 139,845,469	131,359,273	123,914,115	8,486,196	6.5%

Investment income was up this year from last due to an increase in interest rates. Expenses increased from last year by 9.2%, which is due to the operational cost to maintain the new groundwater treatment facility. There was also a greater emphasis on additional infrastructure rehabilitation. Revenues increased 17.0% from last year, which was mainly a result of a rate increase in water and sewer service. There was also a significant increase in the number of new homes under construction. In addition, the Authority received \$634,885 in proffers from developers to help mitigate impacts of new development.

Investment income was down in 2004 from 2003 due to the interest rates continuing to remain at a low rate of return. Expenses increased in 2004 from 2003 by 10.4%, which is due to costs associated with Hurricane Isabel and interest payments on the revenue bond. Revenues increased 12.5% in 2004 from 2003, which was mainly a result of a rate increase in water and sewer service as well as customer growth.

Capital Assets

At the end of fiscal year 2005, the Authority had invested \$125,929,218 in a broad range of capital assets, including land and land improvements, water and sewer systems, office fixtures and equipment, and automotive equipment. This amount represents a 5.3% net increase from last year. This increase was primarily the result of the contribution of water and sewer systems to the Authority during fiscal year 2005. Construction in progress

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decreased by 89.4% over last year. This decrease was primarily due to the completion of the groundwater treatment facility and the First Colony waterline replacement.

At the end of fiscal year 2004, the Authority had invested \$119,563,991 in a broad range of capital assets, including land and land improvements, water and sewer systems, office fixtures and equipment, and automotive equipment. This amount represents a 14.7% net increase from 2003. This increase was primarily the result of the contribution of water and sewer systems to the Authority during fiscal year 2004. Construction in progress also increased by 30.7% over 2003. This increase is mostly a result of costs incurred for the final phase of the Supervisory Control and Data Acquisition System, construction of a groundwater treatment facility located at 4321 John Tyler Highway, replacement of waterlines in First Colony, and the replacement of lift station 1-2 located at 3900 John Tyler Highway.

The following table summarizes the Authority's capital assets at June 30, 2005, 2004 and 2003:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Utility plant:			
Land and land rights	\$ 910,138	910,138	887,638
Water and sewer systems	<u>173,024,309</u>	<u>148,684,658</u>	<u>132,987,980</u>
Total utility plant	<u>173,934,447</u>	<u>149,594,796</u>	<u>133,875,618</u>
Non-utility plant:			
Land	1,584,998	1,580,428	1,580,428
Central shop	1,955,674	1,955,674	1,955,674
Office fixtures and equipment	868,535	761,881	738,056
Land improvements	13,183	13,183	13,183
Automotive equipment	<u>1,881,662</u>	<u>1,733,139</u>	<u>1,674,653</u>
Total non-utility plant	6,304,052	6,044,305	5,961,994
Construction in progress	1,632,162	15,357,443	11,749,571
Less accumulated depreciation	<u>55,941,443</u>	<u>51,432,553</u>	<u>47,362,845</u>
Net capital assets	<u>\$ 125,929,218</u>	<u>119,563,991</u>	<u>104,224,338</u>

Debt Administration

At the close of the current fiscal year, the Authority's total outstanding debt was \$13,390,000. During fiscal year 2003, the Authority issued revenue bonds in the amount of \$14,650,000 to finance a groundwater treatment facility, wells and water transmission lines and to provide for the costs of issuing the bonds and funding any necessary reserves. The revenue bonds ratings are Aaa from Moody's and AAA from Standard & Poor's rating services based on the municipal bond insurance policy by the Insurer. The Series 2003 bonds have been assigned an underlying rating of AA by Standard & Poor's and of A1 by Moody's without giving effect to the issuance of the municipal bond insurance policy by the Insurer. These ratings allowed the Authority to borrow at lower interest rates. At the close of fiscal year 2004, the Authority's total outstanding debt was \$14,215,000.

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Economic Factors and Next Year Budgets and Rates

During the current fiscal year, the unrestricted net assets increased to \$27.1 million from \$23.4 million at June 30, 2004. The Authority did not appropriate any of this for spending during fiscal year 2006.

Overall, the portion of the budget for water operations is projected to decrease by 1.6% in fiscal 2006 from the 2005 budget level. The revenue decrease is due primarily to an overestimate of residential service charges. There were no changes to the rates for the 2006 budget.

The water operation expenses also reflect a corresponding decrease for the water facility Operating Reserve. In addition, this includes a transfer from water operations to the Capital Improvement Program for repairs, renewal and replacement costs. Personnel expenses include three new full-time permanent positions.

Overall, the fiscal year 2006 sewer operation budget will increase 3.9% from 2005. The revenue increase is primarily due to an increase in customer growth.

The sewer operation reflects an increase to direct sewer expenses primarily for infrastructure maintenance and utilities. Personnel expenses include one new full-time permanent position. A total of \$219,197 will be transferred from sewer operations to the Capital Improvements Program for repair, renewal, and replacement costs.

Contacting the Authority's Financial Management

This financial report is designed to provide our customers and creditors with a general overview of the Authority's finances and to demonstrate the Authority's accountability for the money it receives. Questions concerning this report or requests for additional information should be directed to the James City County Department of Financial and Management Services, 101-F Mounts Bay Road, P.O. Box 8784, Williamsburg, Virginia 23187-8784.