

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

Management's Discussion and Analysis

June 30, 2008 and 2007

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, 2008 and 2007.

Financial Highlights for Fiscal Years 2008 and 2007

- * The Authority's total net assets were \$170.7 million at June 30, 2008, which represents a 2.8% increase from 2007. Total net assets at June 30, 2007 were \$166.0 million.
- * The Authority's total operating expenses before depreciation and amortization increased by 8.3% in 2008 from 2007, and total operating revenues decreased by 6.5% in 2008 from 2007. Total operating expenses before depreciation and amortization increased by 13.7% in 2007 from 2006, and total operating revenues increased by 19.4% in 2007 from 2006.
- * Capital assets increased by 0.6% in 2008 from 2007. This was primarily due to the formal acceptance of 5 new water system dedications and 9 new sewer system dedications. Capital assets increased by 4.8% in 2007 from 2006. This was primarily due to the formal acceptance of 16 new water system dedications and 14 new sewer system dedications. In addition, new vehicles were purchased during that year.

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, it is also important to consider other nonfinancial 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 \$4.7 million. This increase is primarily related to the contribution of water and sewer systems to the Authority. The Authority's net assets increased by \$11.0 million in 2007 from 2006 (as restated). This increase is also primarily related to the contribution of water and sewer systems to the Authority.

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Management's Discussion and Analysis

June 30, 2008 and 2007

Condensed Balance Sheet Information at June 30

	2008	2007	2006, as restated	2008 vs. 2007	
				\$ Change	% Change
Capital assets	\$ 145,126,001	144,278,943	137,689,519	847,058	0.6%
Current and other assets	39,613,363	36,617,714	32,609,367	2,995,649	8.2
Total assets	\$ 184,739,364	180,896,657	170,298,886	3,842,707	2.1
Current liabilities	\$ 3,288,996	3,185,742	3,002,823	103,254	3.2
Long-term liabilities	10,725,154	11,704,627	12,310,220	(979,473)	(8.4)
Total liabilities	14,014,150	14,890,369	15,313,043	(876,219)	(5.9)
Net assets:					
Invested in capital assets, net of related debt	133,913,331	132,145,149	124,654,601	1,768,182	1.3
Restricted for capital projects	705,775	709,584	703,494	(3,809)	(0.5)
Unrestricted	36,106,108	33,151,555	29,627,748	2,954,553	8.9
Total net assets	170,725,214	166,006,288	154,985,843	4,718,926	2.8
	\$ 184,739,364	180,896,657	170,298,886	3,842,707	2.1%

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

JAMES CITY SERVICE AUTHORITY
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Management's Discussion and Analysis

June 30, 2008 and 2007

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

	2008	2007	2006, as restated	2008 vs. 2007	
				\$ Change	% Change
Water and sewer services	\$ 11,211,578	11,464,460	10,269,798	(252,882)	(2.2)%
Other	1,299,356	1,747,670	930,060	(448,314)	(25.7)
Reimbursement for storm costs	—	161,573	—	(161,573)	(100.0)
Facility charges	3,428,121	5,904,875	6,132,383	(2,476,754)	(41.9)
Nonoperating revenues	2,176,816	1,503,939	935,971	672,877	44.7
Total revenues	18,115,871	20,782,517	18,268,212	(2,666,646)	(12.8)
Salaries	1,016,005	1,020,053	762,584	(4,048)	(0.4)
Fringe benefits	396,771	409,947	265,520	(13,176)	(3.2)
Operating supplies	708,433	737,092	560,840	(28,659)	(3.9)
Maintenance of buildings and equipment	1,170,192	793,764	637,345	376,428	47.4
Special services	5,717,101	5,168,706	4,877,696	548,395	10.6
Utilities	809,577	640,890	651,820	168,687	26.3
Water purchases	349,351	285,190	320,509	64,161	22.5
Storm costs	—	161,349	—	(161,349)	(100.0)
Other	38,169	203,327	207,397	(165,158)	(81.2)
Depreciation and amortization	5,864,920	5,594,153	5,330,865	270,767	4.8
Nonoperating expenses	480,584	2,674,057	534,642	(2,193,473)	(82.0)
Total expenses	16,551,103	17,688,528	14,149,218	(1,137,425)	(6.4)
Excess of revenues over expenses	1,564,768	3,093,989	4,118,994	(1,529,221)	(49.4)
Capital contributions	3,154,158	7,926,456	10,077,376	(4,772,298)	(60.2)
Change in net assets	4,718,926	11,020,445	14,196,370	(6,301,519)	(57.2)
Net assets at beginning of year	166,006,288	154,985,843	140,789,473	11,020,445	7.1
Net assets at end of year	\$ <u>170,725,214</u>	<u>166,006,288</u>	<u>154,985,843</u>	<u>4,718,926</u>	<u>2.8%</u>

Revenues decreased 12.8% from 2007, which was primarily due to a reduction in the facility charges collected. New water connections reduced from 694 in 2007 to 351 in 2008 and new sewer connections reduced from 693 in 2007 to 389 in 2008. In addition, the Authority implemented a new billing system this year with HRSD. While water usage did increase, the Authority saw a decline in service charge revenue. This was primarily a result of adjustments made to accounts by HRSD. The Authority also had one time funding in 2007 for storm cost reimbursement and the agreement with the Economic Development Authority for the Stonehouse water tower (see note 12 on page 27). The Authority received \$502,217 in proffers from developers to fund capital improvements due to growth. Expenses decreased from last year by 6.4%, which is primarily due to reduction in nonoperating expenses from the lift station donations in 2007. There was an increase in special services, which is a result of a new position being approved during the current fiscal year, bad debt expenses related to accounts receivable and increased fuel costs.

Revenues increased 13.8% in 2007 from 2006, which was primarily a result of an increase in water service charges, as well as an increase in customer growth. In addition, the Authority received \$530,518 in proffers from developers to help mitigate impacts of new development. Investment income was up in 2007 from 2006 due to an increase in interest rates. Expenses increased from 2006 by 25.0%, which was primarily due to the Authority donating two lift stations to HRSD. This donation resulted in a loss on disposal of capital assets. In addition,

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June 30, 2008 and 2007

there was an increase in special services, which was a result of new positions being approved during fiscal year 2007.

Capital Assets

At the end of fiscal year 2008, the Authority had invested \$145,126,001 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 0.6% 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 2008. Construction in progress decreased by 59.8% over last year. This decrease was primarily a result of capitalizing water storage tanks at Season's Trace and the Stonehouse area and the second phase of the Five Forks Water Treatment Facility. The construction in progress includes continued construction of the Raleigh Square waterline and Powhatan Creek sewer interceptor rehabilitation.

At the end of fiscal year 2007, the Authority had invested \$144,278,943 in capital assets. This amount represents a 4.8% net increase from 2006. This increase was primarily the result of the contribution of water and sewer systems to the Authority during fiscal year 2007. Construction in progress increased by 74.8% over 2006. This increase was primarily due to the continued construction of water storage tanks at Season's Trace and the Stonehouse area and the second phase of the Five Forks Water Treatment Facility.

For further information, see Notes to Basic Financial Statements (pgs. 13-27). Additional information on the Authority's capital assets can be found in Note 3 on pages 20-21. The following table summarizes the Authority's capital assets at June 30, 2008, 2007, and 2006:

	<u>2008</u>	<u>2007</u>	<u>2006, as restated</u>
Utility plant:			
Land and land rights	\$ 1,010,933	954,738	890,438
Water and sewer systems	204,427,407	192,828,628	184,876,629
Total utility plant	<u>205,438,340</u>	<u>193,783,366</u>	<u>185,767,067</u>
Nonutility property:			
Land	1,754,961	1,762,961	1,785,961
Central shop	2,070,494	1,952,567	1,903,142
Office fixtures and equipment	982,682	950,603	925,966
Land improvements	13,183	13,183	13,183
Automotive equipment	2,003,647	2,012,538	1,958,287
Total nonutility property	<u>6,824,967</u>	<u>6,691,852</u>	<u>6,586,539</u>
Construction in progress	3,582,979	8,913,781	5,098,030
Less accumulated depreciation	70,720,285	65,110,056	59,762,117
Net capital assets	<u>\$ 145,126,001</u>	<u>144,278,943</u>	<u>137,689,519</u>

JAMES CITY SERVICE AUTHORITY
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Management's Discussion and Analysis

June 30, 2008 and 2007

Debt Administration

At the close of the current fiscal year, the Authority's total outstanding bonded debt was \$10,810,000 (before premiums). 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 2007, the Authority's total outstanding debt was \$11,690,000 (before premiums). For further information on the Authority's outstanding debt, see Note 5 on pages 22-23.

In August 2008, the Authority issued revenue bonds totaling \$27,120,000 to finance the purchase from the City of Newport News, Virginia of a "safe yield share" of treated water capacity from the King William Reservoir Project or an alternate water supply source. The Authority also experienced an upgrade to their bond rating to AA+ by Standard & Poor's and Aa3 by Moody's Investors Service. Standard & Poor's issues ratings ranging from AAA to D to designate the relative investment qualities of bonds. Moody's issues ratings ranging from Aaa to C to designate the relative investment qualities of bonds.

Economic Factors and Next Year Budgets and Rates

During the current fiscal year, the unrestricted net assets increased to \$36.1 million from \$33.2 million at June 30, 2007. The Authority did not appropriate any of this for spending during fiscal year 2009.

Overall, the portion of the budget for water operations is projected to increase by 7.4% in fiscal year 2009 from the 2008 budget. The revenue increase is due to an increase in water service rates, plan review fees, inspection fees for water and sewer lines and projected new customer growth. The water operation expenses also reflect an increase, including one new full-time position, as well as a general salary increase. In addition, this budget includes \$329,674 for the first year share of the Project Development Agreement (PDA) operating cost with City of Newport News. The PDA operating costs include land lease payments, maintenance and repair, materials and manpower of the reservoir.

Overall, the fiscal year 2009 sewer operating budget will increase by 9.7% from the 2008 budget. The revenue increase is due to an increase in the annual grinder pump maintenance charge and projected new customer growth. The sewer operation expenses also reflect an increase, including the manhole rehabilitation program, installation of Transient Voltage Surge Suppression (TVSS) devices at 24 lift stations, construction of a warehouse pipe rack, replacement of one lift station generator, increase to grinder pump operational costs and a salary increase for employees.

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.