
MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the City of North Augusta, South Carolina's (the "City") annual financial report presents our discussion and analysis of the City's financial performance for the fiscal year ended December 31, 2007. We encourage readers to consider the information presented here in conjunction with the additional information that we have furnished in our Letter of Transmittal at the front of this report and the City's financial statements, which follow this section.

Financial Highlights

Per the Government-Wide Statement of Net Assets, the assets of the City at the close of the most recent fiscal year exceeded its liabilities by \$100,243,808 (*net assets*). Of this amount, \$23,903,252 was unrestricted and available for spending at the government's discretion.

Per the Government-Wide Statement of Activities, the City's total net assets increased by \$13,646,116 for the year ended December 31, 2007. The governmental activities contributed \$9,529,315 and the business-type activities contributed \$4,116,801 of the net change in net assets.

During 2007, the City entered into a \$6,350,000 capital lease. The proceeds from the lease will be used to finance a portion of the City's new Municipal Center. The revenue stream used to make the lease payments will come from the City's local hospitality and local accommodations taxes currently collected in the Riverfront/Central Core Redevelopment Fund. The lease's interest rate is 3.64% and matures December 20, 2024.

At December 31, 2007, construction was approximately 25% complete on the City's new \$20,000,000 Municipal Center. Funding for the Municipal Center will come from a combination of GOB debt, a capital lease, proceeds from the Capital Project Sales Tax and City reserves. The approximately 70,000 square foot facility is being constructed on Georgia Avenue in the downtown area and will house the City administrative offices and Council Chambers. Additionally, approximately 40% of the center will also be used as a cultural and historical display area and special events space. The center is scheduled for completion in early 2009.

The City sold more water in 2007, 1,497,158,760 gallons generating \$3,450,728 in water sales, than in any previous year. These record water sales were attributed to the unusually dry year, with rainfall down significantly from previous years.

Overview of the Financial Statements

Management's Discussion and Analysis (MD&A) serves as an introduction to the City's basic financial statements. Those financial statements comprise 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 themselves. The Letter of Transmittal and the Statistical Section of the Comprehensive Annual Financial Report (CAFR), of which this discussion is a component

thereof, contains much of the data and analysis usually included in a MD&A and therefore it is not duplicated herein.

Government-Wide Financial Statements

The *government-wide financial statements* are designed to provide readers with a broad overview of the City finances, in a manner similar to a private-sector business.

The *statement of net assets* presents information on all of the City's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases and decreases in net assets may serve as a useful indicator of whether financial position of the City is improving or deteriorating.

The *statement of activities* presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported on the accrual basis as soon as the underlying event giving rise to the change occurs, *regardless of the time 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 City that are principally supported by taxes and intergovernmental revenues (*governmental activities*) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (*business-type activities*). The governmental activities of the City include general government, public safety, public works, and recreation and parks. The business-type activities of the City include a water and sewer utility, sanitation services, and stormwater enterprise.

The government-wide financial statements can be found immediately following this Management's Discussion and Analysis.

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 City, like other local governments, uses fund accounting to ensure and demonstrate compliance with finance-related requirements. All of the funds of the City can be divided into two categories: governmental funds and proprietary funds. The City does not have a fiduciary fund.

Governmental funds – *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 a government'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 government's near-term 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 City maintains ten individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balance for the General Fund, which is considered a major fund. Information is also presented separately for the Sales Tax Fund, Sales Tax II Fund, Capital Projects Fund and Riverfront/Central Core Redevelopment Fund, which also meet the criteria for a major fund. Information from the other five governmental funds is combined into a single, aggregated presentation. Individual fund data for each of these nonmajor governmental funds is provided in the form of combining statements on pages 79-83 of this report.

The City adopts an annual appropriated budget for its General Fund. A budgetary comparison statement has been provided for the General Fund to demonstrate compliance with the budget.

The basic governmental fund financial statements can be found on pages 16-17 of this report.

Proprietary funds – *Enterprise funds* are used to report the same functions presented as *business-type* activities in the government-wide financial statements. The City uses enterprise funds to account for its water and sewer, sanitation, and stormwater enterprises. Additionally on January 1, 2007, a fourth enterprise fund entitled the Savannah Bluff Lock and Dam Fund was created for the purpose of maintaining the Augusta pool on the Savannah River. Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The basic proprietary fund financial statements can be found immediately following the “Governmental Fund” financial statements.

The City adopts an annual appropriated budget for each enterprise fund. A budgetary comparison statement has been provided for each enterprise fund to demonstrate compliance with the budget.

The basic proprietary fund financial statements can be found on pages 20-24 of this report.

Notes to the Financial Statements – The notes provide additional information that is essential to 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 25-45 of this report.

Other Financial Information – In addition to the basic financial statements, the accompanying notes and the required supplementary information, this report presents certain financial data of individual fund statements and schedules.

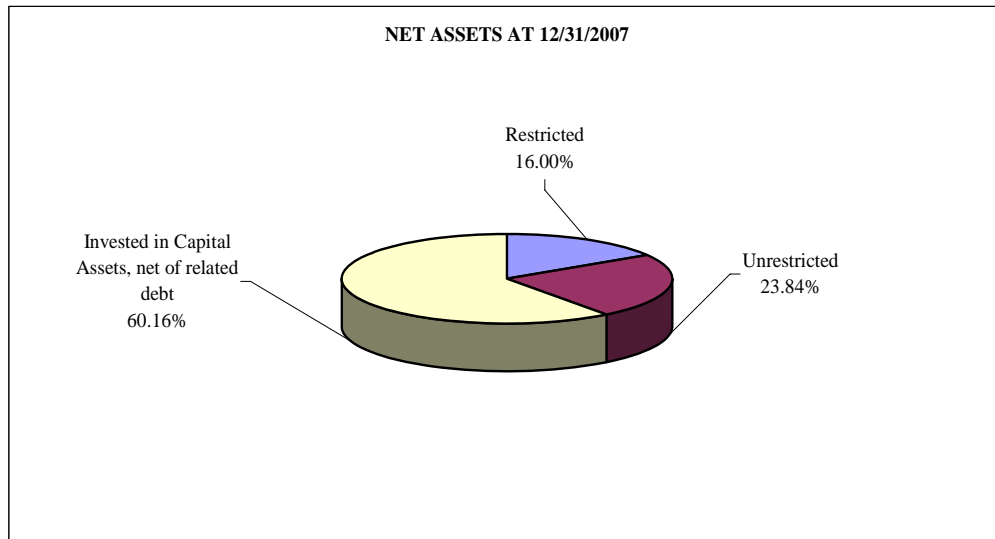
Government-Wide Financial Analysis

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the City, assets exceeded liabilities by \$100,243,808 at the close of the most recent fiscal year.

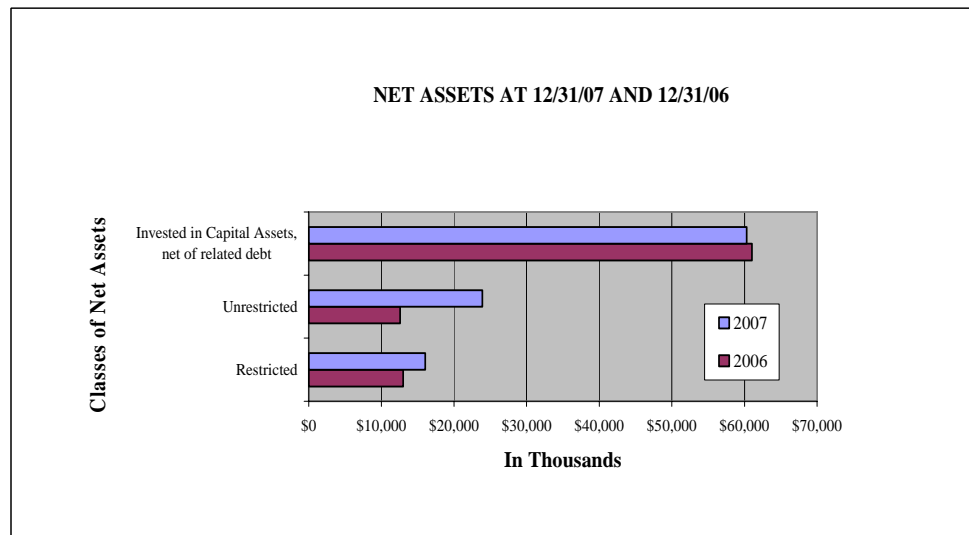
By far, the largest portion of the City's net assets (\$60,304,957, or 60.16%) reflects its investment in capital assets (e.g., land, land improvements, right-of-way and easements, buildings, machinery and equipment, furniture and fixtures, vehicles, infrastructure, system improvements, PSA capital, and construction in progress), less any related debt to acquire those assets that is still outstanding. The City uses these capital assets to provide services to its citizens; consequently these assets are *not* available for future spending. Although the City's investments in its 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.

CITY OF NORTH AUGUSTA'S NET ASSETS						
	Governmental activities		Business-type activities		Total	
	2006	2007	2006	2007	2006	2007
Assets:						
Cash/Investments-Unrestricted	\$10,083,110	\$15,591,206	\$7,507,606	\$8,975,989	\$17,590,716	\$24,567,195
Other Current Assets	90,124	262,467	1,625,895	1,844,632	1,716,019	2,107,099
Cash/Investments-Restricted	4,716,068	6,326,000	8,682,947	10,176,571	13,399,015	16,502,571
Capital assets, net of accumulated depreciation	29,802,196	38,442,800	38,809,638	39,686,311	68,611,834	78,129,111
Service rights, net of accumulated depreciation	0	0	53,507	51,007	53,507	51,007
Deferred charges, net of accumulated depreciation	0	0	77,274	70,636	77,274	70,636
TOTAL ASSETS	\$44,691,498	\$60,622,473	\$56,756,867	\$60,805,146	\$101,448,365	\$121,427,619
Liabilities:						
Current liabilities	\$641,608	\$594,515	\$914,995	\$1,396,559	\$1,556,603	\$1,991,074
Noncurrent liabilities	5,967,491	12,416,244	7,326,579	6,776,493	13,294,070	19,192,737
TOTAL LIABILITIES	\$6,609,099	\$13,010,759	\$8,241,574	\$8,173,052	\$14,850,673	\$21,183,811
Net Assets:						
Net invested in capital assets	\$28,977,233	\$26,808,692	\$32,069,057	\$33,496,265	\$61,046,290	\$60,304,957
Restricted	4,716,068	6,326,000	8,263,966	9,709,599	12,980,034	16,035,599
Unrestricted	4,389,098	14,477,022	8,182,270	9,426,230	12,571,368	23,903,252
TOTAL NET ASSETS	\$38,082,399	\$47,611,714	\$48,515,293	\$52,632,094	\$86,597,692	\$100,243,808

An additional portion of the City's net assets (\$16,035,599 or 16.00%) represents resources that are subject to external restrictions on how they may be used. The remaining balance of *unrestricted net assets* (\$23,903,252 or 23.84%) may be used to meet the government's ongoing obligations to citizens and creditors.



At the end of the current fiscal year, the City is able to report “positive” balances in all three categories of net assets, both for the government as a whole, as well as for its separate governmental and business-type activities.



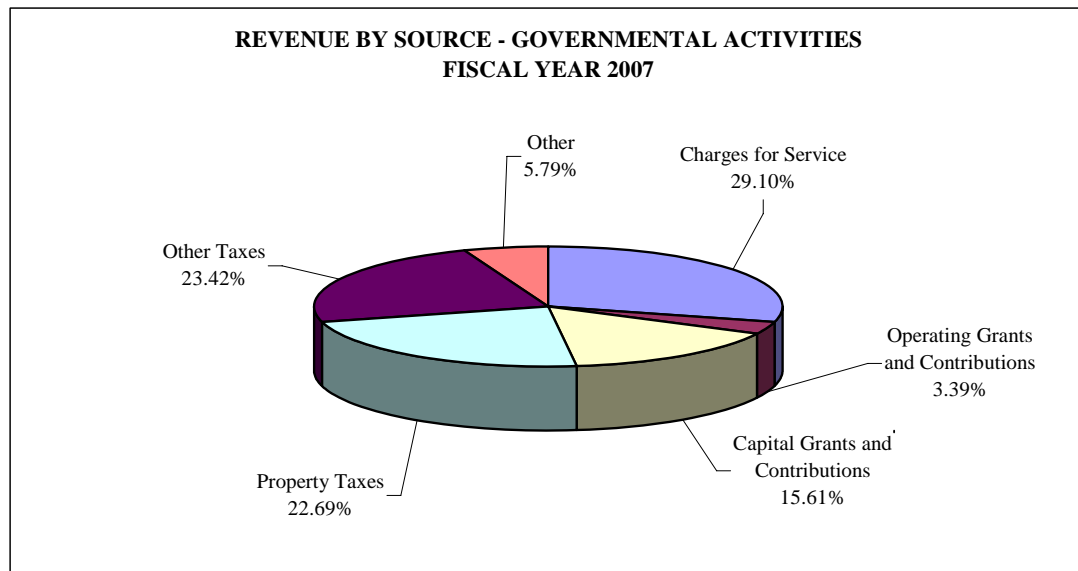
Governmental Activities

Governmental activities increased the City's net assets by \$9,529,315, thereby accounting for 69.83% of the total growth in net assets. Governmental expenditures are funded by fees for services, grants and contributions, and general revenues. The Statement of Activities details this activity for the City. The following chart summarizes this data for governmental and business-type activities.

CITY OF NORTH AUGUSTA'S CHANGES IN NET ASSETS						
	Governmental activities		Business-type activities		Total	
	2006	2007	2006	2007	2006	2007
Revenues:						
Program revenues:						
Charges for services	\$6,018,149	\$6,482,587	\$10,347,907	\$11,449,325	\$16,366,056	\$17,931,912
Operating grants and contributions	690,426	754,944	0	0	690,426	754,944
Capital grants and contributions	1,528,331	3,477,186	687,953	1,600,851	2,216,284	5,078,037
General revenues:						
Property taxes	4,893,615	5,054,065	0	0	4,893,615	5,054,065
Other taxes	1,117,328	5,217,209	0	0	1,117,328	5,217,209
Other	869,109	1,290,827	932,490	1,110,489	1,801,599	2,401,316
TOTAL REVENUES	\$15,116,958	\$22,276,818	\$11,968,350	\$14,160,665	\$27,085,308	\$36,437,483
Expenses:						
General government	\$2,858,015	\$3,283,604	\$0	\$0	\$2,858,015	\$3,283,604
Public safety	4,624,981	4,955,943	0	0	4,624,981	4,955,943
Public works	1,516,253	1,487,012	0	0	1,516,253	1,487,012
Recreation and parks	2,928,875	3,327,793	0	0	2,928,875	3,327,793
Interest and bank fees	23,700	24,001	0	0	23,700	24,001
Water and sewer	0	0	6,080,671	6,364,814	6,080,671	6,364,814
Sanitation	0	0	2,845,766	3,066,729	2,845,766	3,066,729
Stormwater	0	0	276,721	281,471	276,721	281,471
TOTAL EXPENSES	\$11,951,824	\$13,078,353	\$9,203,158	\$9,713,014	\$21,154,982	\$22,791,367
Increase in net assets before transfers	\$3,165,134	\$9,198,465	\$2,765,192	\$4,447,651	\$5,930,326	\$13,646,116
Transfers	315,993	330,850	-315,993	-330,850	0	0
Increase in net assets	3,481,127	9,529,315	2,449,199	4,116,801	5,930,326	13,646,116
Net assets - Beginning of year	34,601,272	38,082,399	46,066,094	48,515,293	80,667,366	86,597,692
Net assets - End of year	\$38,082,399	\$47,611,714	\$48,515,293	\$52,632,094	\$86,597,692	\$100,243,808

Governmental activities revenues increased from \$15,116,958 to \$22,276,818 in 2007. Charges for services (\$6,482,587) include business license revenues, franchise fees, construction permits and public safety fines and represent 29.10% of total governmental revenues. These revenues are predominantly elastic in nature and vary with economic trends and are evidence of North Augusta's vibrant economy, growing by 7.72% in 2007. Operating grants and contributions and capital grants and contributions increased by \$64,518 and \$1,948,855, respectively in 2007.

Property taxes increased by \$160,450 or 3.28% during the year. Other taxes consisting of the One-cent Capital Projects Sales Tax II and the City's Local Hospitality and Accommodations Tax increased by \$4,099,881. Fiscal year 2007 was the first full year of the One-cent Capital Projects Sales Tax revenue (Sales Tax II) from the sales tax program adopted in November of 2004. Additionally, the City received its final allocation of One-cent Capital Projects Sales Tax I proceeds representing excess collections from the Sales Tax I program.



In 2007, governmental activities expenditures increased from \$11,951,824 to \$13,078,353 or 9.43%. Fuel cost increases City-wide, additional personnel, and salary and fringe benefit increases account for the majority of this increase. General government expenditures increased by \$425,589 or 14.89%, primarily due to increased personnel related expenditures and computer software enhancements. Expenditures in public safety for 2007 increased by \$330,962 from \$4,624,981 to \$4,955,943 or 7.16%, primarily due to an increase in personnel related expenditures and fuel cost. Public works expenditures decreased by \$29,241 or 1.93% from \$1,516,253 to \$1,487,012 in 2007. Expenditures in recreation and parks for 2007 increased by \$398,918 or 13.62% due to the addition of several beautification areas in the City.

Business-type Activities

The City operates four enterprises that comprise its business-type activities. The Water and Sewer System, Sanitation Services Funds, and Stormwater Fund are classified as major funds. The Savannah Bluff Lock and Dam Fund, a nonmajor fund, was created on January 1, 2007 for the ultimate purpose of maintaining the Augusta pool on the Savannah River. The City of North Augusta entered into an agreement with the City of Augusta, the County of Aiken and four industrial stakeholders for the future operations and maintenance of the Savannah Bluff Lock & Dam. The agreement is contingent based on future upgrades to the Savannah Bluff Lock and Dam by the United States Corps of Engineers. The agreement calls for the establishment of an

escrow account in the amount of \$1,000,000 to be established over a three-year period. The only activity of the fund during 2007 was the partial funding of this escrow account.

Business-type activities increased the City's net assets by \$4,116,801, accounting for 30.17% of the total growth in net assets. Charges for services increased by \$1,101,418 or 10.64%, from \$10,347,907 in 2006 to \$11,449,325 in 2007. The majority of this increase, \$807,312 or 73.30% is attributed to a record year in water sales due to an unusually dry year, with rainfall down significantly from 2006. Additionally the Sanitation Fund experienced a very positive year with recycling fees and recyclable sales increasing by 24.30% from \$875,274 in 2006 to \$1,087,988 in 2007. Finally, the initiation of the Savannah Bluff Lock and Dam Fund and the associated revenue stream contributed significantly to the increase in charges for services.

Expenses for the Water and Sewer System increased from \$6,080,671 in 2006 to \$6,364,814 in 2007 or \$284,143. The majority of this increase, \$100,081 or 35.22% was attributed to increased sewerage treatment cost resulting from a redistribution of flow at the Horse Creek Basin Wastewater Treatment Facility. The increase in the City's treatment cost can be attributed to a large extent to the closing of several textile mills in the region, causing a shift of expenses from the industrial customers to the governmental customers.

In 2007 the expenses for the Sanitation Services Fund increased \$220,963 (from \$2,845,766 to \$3,066,729). The increase is a direct result of close to full staffing in the Sanitation Department and the Material Recovery Center and an increase in operating expenses, primarily fuel oil products, which increased significantly during 2007.

The expenses in the Stormwater Utility Fund increased by only \$4,750 (from \$276,721 in 2006 to \$281,471 in 2007).

General Fund Budgetary Highlights

For the fiscal year 2007 the City adopted a balanced budget in the General Fund. The General Fund budgeted revenues amounted to \$11,618,355 including operating transfers in of \$330,850 from the major enterprise funds. The City does not budget proceeds from capital lease obligations, which amounted to \$339,632 in 2007. For 2007 actual General Fund revenues exceeded budgeted revenues by \$697,054. Current taxes in the General Fund grew by only \$49,358 or 1.18%. This low growth rate is attributed to the adoption of State legislation in 2001 that decreased the personal property assessment from 10.5% to 6.0% over a six year period beginning in 2002 and ending in 2007. Revenues from business licenses and construction permits increased from \$4,177,540 in 2006 to \$4,552,001 in 2007 or \$374,461, which is indicative of a continued strong local economy. Revenue from public safety fines increased significantly by \$71,348 from \$855,129 in 2006 to \$926,477 in 2007. Charges for services, primarily recreation fees, grew modestly by \$18,629 from \$985,480 in 2006 to \$1,004,109 in 2007. Intergovernmental revenue increased by \$61,802 or 9.40% from \$658,827 in 2006 to \$720,629 in 2007. Miscellaneous revenue grew by \$34,790 or 7.89% due to primarily to increased interest earnings and revenue from the rental of communication tower to cellular companies. Actual expenditures in the General Fund exceeded budget at the Public Safety and

Recreation and Parks functional levels due to the purchase of equipment with capital lease proceeds; however, overall actual General Fund expenditures for 2007 were within budget.

Budget Amendments – There were no budget amendments in any fund for fiscal year 2007.

Capital Asset and Debt Administration

Capital Assets – The City’s investment in capital assets for its governmental and business-type activities as of December 31, 2007, amounts to \$78,129,109 (net of accumulated depreciation). This investment in capital assets includes land, land improvements, right-of-way and easements, buildings, machinery and equipment, furniture and fixtures, infrastructure, system improvements, PSA capital, and construction in progress.

CITY OF NORTH AUGUSTA'S CAPITAL ASSETS (net of depreciation)						
	Governmental activities		Business-type activities		Total	
	2006	2007	2006	2007	2006	2007
Land	\$6,299,578	\$5,665,136	\$768,516	\$768,516	\$7,068,094	\$6,433,652
Land Improvements	3,075,234	4,506,439	0	0	3,075,234	4,506,439
Right-of-way and easements	1,838,350	2,238,430	62,760	62,760	1,901,110	2,301,190
Buildings	5,559,851	5,319,503	1,859,847	1,765,835	7,419,698	7,085,338
Machinery and equipment	447,060	595,649	823,302	819,959	1,270,362	1,415,608
Furniture and fixtures	179,230	176,414	0	0	179,230	176,414
Vehicles	1,270,595	1,273,187	1,163,669	939,056	2,434,264	2,212,243
Infrastructure	8,156,021	11,879,843	0	0	8,156,021	11,879,843
System Improvements	0	0	32,675,251	33,347,449	32,675,251	33,347,449
PSA Capital	0	0	1,115,786	1,045,482	1,115,786	1,045,482
Construction in progress	2,976,277	6,788,199	340,505	937,252	3,316,782	7,725,451
TOTAL CAPITAL ASSETS	\$29,802,196	\$38,442,800	\$38,809,636	\$39,686,309	\$68,611,832	\$78,129,109

The City has committed \$5,800,000 to the ongoing Mims Branch sewer line extension project which should be completed in late 2008. In addition, the City has committed \$2,301,014 to the West Avenue Streetscape project and \$618,613 to a Greenway extension (Pisgah to Bergen). These projects should also be completed in 2008 and will require no future financing. Finally, the City has committed approximately \$20,000,000 to the construction of a new Municipal Center. The Municipal Center project is well underway and is scheduled for completion in early 2009. No additional financing will be required to complete this project. Additional information on the City’s capital assets can be found in *Note 3* on pages 34-36 of this report.

Long-Term Debt – At the end of the current fiscal year, the City had total bonded debt outstanding of \$10,305,741. General Obligation Bonds outstanding comprise 45.76% and Revenue bonds outstanding (net of deferred refunding) comprise 54.24% of the total amount of the City’s outstanding bonded debt.

CITY OF NORTH AUGUSTA'S OUTSTANDING BONDED DEBT						
	Governmental activities		Business-type activities		Total	
	2006	2007	2006	2007	2006	2007
General Obligation Bonds (GOB)	\$4,716,068	\$4,716,068	\$0	\$0	\$4,716,068	\$4,716,068
Revenue bonds, net of deferred refunding	0	0	5,953,406	5,589,673	5,953,406	5,589,673
TOTAL DEBT	\$4,716,068	\$4,716,068	\$5,953,406	\$5,589,673	\$10,669,474	\$10,305,741

The City's total bonded debt outstanding (net of deferred refunding of a 1998 revenue bond) decreased by \$363,733 during the current fiscal year. This decrease was attributed to the annual payment of principal for the City's revenue bonds.

The City's last rated revenue bond issued in 1998 in the amount of \$4,603,000 was rated **Aaa insured** by Moody's Investors Service, Inc., and **AAA insured** by Standard and Poor's Corporation. The City's debt coverage requirement, remaining very strong, increased significantly from 2.65 to 3.80. The City's bond covenants require coverage of 1.25 to issue additional bonds. Please refer to Table XV on page 136 for additional information regarding the City's revenue bond coverage.

The City's General Obligation Bond, Series 2006 in the amount of \$4,716,068 was rated **A2** by Moody's Investor's Service, Inc. and **A** by Standard & Poor's Corporation.

Other long-term debt at the end of the current fiscal year included \$1,393,411 in capitalized leases for furniture, equipment, and machinery, \$434,407 in compensated absences, and \$6,350,000 in a capital lease (Municipal Center Lease, 2007) designated for the City's new Municipal Center.

Additional information of the City's long-term debt can be found in *Notes 5 and 6* on pages 37-42 of this report.

Request for Information

The financial report is designed to provide a general overview of the City's finances for all those with an interest in its 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, City of North Augusta, P.O. Box 6400, North Augusta, SC 29861-6400.