

MANAGEMENT DISCUSSION AND ANALYSIS FOR THE YEAR ENDED JUNE 30, 2007

As management of the City of Groton, we offer readers of the City of Groton's financial statements this narrative overview and analysis of the financial activities of the City of Groton for the year ended June 30, 2007. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in our letter of transmittal.

Financial Highlights

- The assets of the City exceeded its liabilities at the close of the most recent fiscal year by \$71,305,231 (net assets). Of this amount, \$21,541,878 (unrestricted net assets) may be used to meet the City's ongoing obligations to citizens and creditors.
- On the government-wide basis, the City's total net assets increased by \$1.1 million for the fiscal year, \$0.9 million from the government activities and \$0.2 million increase from the business-type activities.
- As of the close of the current fiscal year, the City's governmental funds reported combined ending fund balances of \$4,615,539, a decrease of \$2,584,717 in comparison with the prior year. Approximately 98% of this total amount, \$4,521,930, is available for spending at the City's discretion (unreserved fund balance).
- At the end of the current fiscal year, unreserved fund balance for the general fund was \$2,769,282 or 19.58% of total general fund expenditures and other financing uses.
- The City of Groton's total debt decreased by a net of \$3,172,355 (8.7%) during the current fiscal year.

Overview of the Financial Statement

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

Government-wide financial statements. The government-wide financial statements are designed to provide readers with a broad overview of the City's 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 or decreases in net assets may serve as a useful indicator of whether the financial position of the City is improving or deteriorating.

The *statement of activities* presents information showing how the City'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 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, highways and streets, sanitation, sewer operation and recreation. The business-type activities of the City include a Water and Electric distribution operation.

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 uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

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 City'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 City'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 City maintains 11 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 balances for the general fund, which is considered to be a major fund. Data from the other 10 governmental funds are combined into a single, aggregated presentation. Individual fund data for each of these non-major governmental funds is provided in the form of combining statements elsewhere in this report.

Major Governmental Fund	Non-major Governmental Funds	
General	State Road Aid	D.A.R.E.
	Forfeiture Grant	Miscellaneous Grants
	Equipment Replacement	Land Acquisition
	Submarine Memorial	
	1994 Sewer Improvements	
	1996 Parks & Recreation Improvements	
	2001 Planning, Design and Construction of New Firehouse	

The City adopts an annual budget for its general fund. A budgetary comparison statement has been provided for the general fund to demonstrate compliance with this budget.

The basic governmental fund financial statements can be found on Exhibits C and D of this report.

Proprietary funds. The City operates two different types of 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 Electric and Water operation. Internal service funds are an accounting device used to accumulate and allocate costs internally among the City's various functions. The City uses internal service funds to account for its self-insured medical benefits and property and general liability claims. These services benefit both governmental and business-type activities and therefore the operations have been recorded in proportion in the respective financial statements.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The proprietary fund financial statements provide separate information for the Electric Department and for the Water System operation, both of which are considered to be major funds of the City. 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 Exhibits G, H and I of this report.

Fiduciary funds. Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are not reflected in the government-wide financial statement because the resources of those funds are not available to support the City's own programs. The accounting used for fiduciary funds is much like that used for proprietary funds.

The basic fiduciary fund financial statements can be on Exhibits J and K of this report.

Notes to the basic 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 basic financial statements can be found on Exhibit L 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 City's progress in funding its obligation to provide pension benefits to its employees.

The combining statements referred to earlier in connection with nonmajor governmental funds and internal service funds are presented immediately following the required supplementary information on pensions.

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 \$71.3 million at the close of the most recent fiscal year.

Summary Statement of Net Assets

June 30, 2007

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	Governmental activities		Business-type activities		Total	
	2007	2006	2007	2006	2007	2006
Current and other assets	\$10,482	\$11,280	\$62,097	\$53,407	\$72,579	\$64,687
Capital assets	23,252	21,146	54,222	50,992	77,474	72,138
Total assets	33,734	32,426	116,319	104,399	150,053	136,825
Long-term liabilities outstanding	5,361	7,369	2,325	30,231	7,686	37,600
Other liabilities	3,049	600	42,007	28,461	45,056	29,061

Total liabilities	8,410	7,969	44,332	58,692	52,742	66,661
Net assets:						
Invested in capital assets, net of related debt	17,259	15,175	22,765	23,958	40,024	39,133
Restricted	848	3,442	8,891	8,911	9,739	12,353
Unrestricted	7,217	5,840	14,325	12,839	21,542	18,679
Total net assets	\$25,324	\$24,457	\$45,981	\$45,708	\$71,305	\$70,165

By far the largest portion of the City's net assets (56.13%) reflects its investment in capital assets (e.g., land, buildings, machinery and equipment and infrastructure), less any related debt used to acquire those assets that is still outstanding. The City uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the City's investment 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.

An additional portion of the City's net assets (13.66%) represents resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets (\$21,541) may be used to meet the City'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 City as a whole, as well as for its separate governmental and business-type activities. The same situation held true for the prior fiscal year.

The City's net assets increased by \$1.1 million during the fiscal year. The increase was due to purchase of land and upgrading of several roads.

Governmental activities. Governmental activities increased the City's net assets by \$0.87 million, thereby accounting for 8 1.34% of the total increase in the net assets of the City.

CITY OF GROTON CHANGES IN NET ASSETS

	Governmental activities		Business-type activities		Total	
	2007	2006	2007	2006	2007	2006
REVENUES:						
Program						

revenues:

Charges for services	\$1,274	\$1,342	\$78,158	\$72,435	\$79,432	\$73,777
Operating grants and contributions	4,969	5,244			4,969	5,244
Capital grants and contributions	-	-			-	-
General revenues:						
Property taxes	5,254	4,747			5,254	4,747
Grants and contributions not restricted to specific programs	122	214			122	214
Other	737	554	2,138	1,255	2,875	1,809
TOTAL REVENUES	12,356	12,101	80,296	73,690	92,652	85,791

EXPENSES:

General government	1,528	1,311			1,528	1,331
Public safety	7,045	6,270			7,045	6,270
Public Works	4,260	4,325			4,260	4,325
Recreation	898	806			898	806
Interest expense	223	231			223	231
Water			7,282	6,480	7,282	6,033
Electric			70,350	63,266	70,350	49,361
TOTAL EXPENSES	13,954	12,963	77,632	69,746	91,586	82,709

Increase in net assets before transfers	(1,598)	(862)	2,664	3,944	1,066	3,082
Transfers	2,465	2,144	(2,465)	(2,144)	-	-
Increase in net assets	867	1,282	199	1,800	1,066	3,082
Net assets -	24,457	23,175	45,782	42,338	70,239	67,082

July 1

Net assets - \$25,324 \$24,457 45,981 \$45,707 \$71,305 \$70,164
June 30

Expenses and Program Revenues - Governmental Activities

Revenues

Governmental activities' revenues totaled \$12.4 million for fiscal year 2007. Property taxes are the second largest revenue source for the City and represent 42.52% of the governmental revenues. Current tax collections were 99.09% of the adjusted tax levy. Operating and capital grants and contributions are the City's largest revenue and represent 40.22% of the governmental revenues. In operating grants and contributions, revenues include Town of Groton's contribution for Police and Highway Department operation, State of Connecticut grants for enterprise zone and manufacturers' machinery and equipment and health district. Charges for services, the third largest revenue amount, represents 10.31% of the governmental revenues. Grants and contributions not restricted to specific programs represent 0.098% and include elderly tax relief and in lieu of tax contributions. Investment income and miscellaneous revenue represents 5.96% of governmental revenues.

- Operating grants and contributions decreased by \$275,000 due to reduction of state grants on manufacturers machinery and equipment. All other variances were not significant.
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Revenues - Governmental Activities



■	Property Taxes
■	Operating Grants, Contributions
□	Charges for Services
□	Capital Grants, Contributions
■	Grants and Contribution not restricted
■	Investment Income

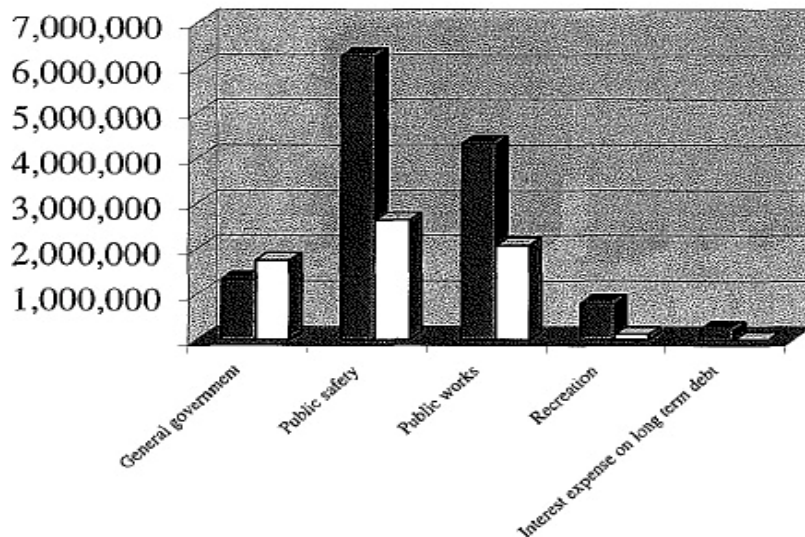
Expenses and Program Revenues - Governmental Activities

Expenses

Governmental expenses totaled \$14.0 million for the fiscal year. Of the expenditures, 50.48% or \$7.0 million is related to public safety. Public works expenses amounted to \$4.3 million, or 30.53%. Recreation expenses amounted to \$0.8 million or 6.43%. Interest expense was \$0.2 million or 1.60%. General government expenses were \$1.5 million or 10.95%.

- General government expenses increased by \$197,576 due to alterations to municipal building offices and the creation of the planning department. In prior years, the planning services were provided by the Town of Groton.
- Public safety expense increased by \$774,622 due to increase in benefits; labor cost in both regular on overtime work; creation of two (2) new full time positions; increase in fuel costs.
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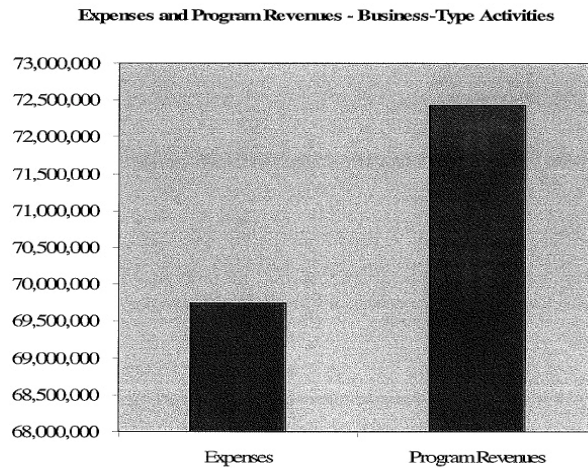
Expenses and Program Revenues Governmental Activities



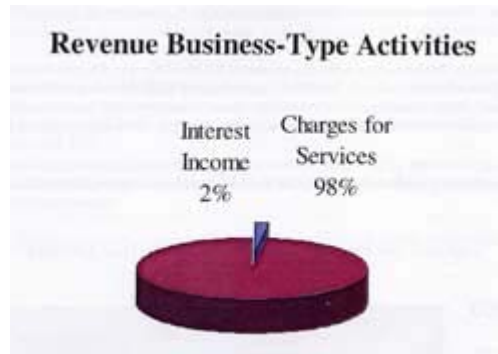
Business-type activities. Business-type activities increased the City's net assets by \$0.2 million, accounting for 18.66% of the total growth in the City's net assets. Key elements of this increase are as follows.

- Charges for services for business-type activities increased by 7.90%. The Electric Department accounts for a significant portion of this increase, 11.20%. The remaining 12.37% increase is attributable to growth in the water sales.

- Investment earnings increased by \$533,477 for business-type activities due to increase in the amount of funds loaned to the taxable company owned by the City. Also, additional funds were available for investment..



Revenue Business-Type Activities



Financial Analysis of the City's Funds

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

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

As of the end of the current fiscal year, the City's governmental funds reported combined ending fund balances of \$4,615,539, a decrease of \$2,584,717 in comparison with the prior year. Approximately 98.44% of this total amount, \$4,521,930, constitutes unreserved fund balance, which is available for spending at the City's discretion. The

remainder of fund balance is reserved to indicate that it is not available for new spending because it has already been committed 1) encumbrances, \$22,739, 2) endowments, \$60,000, or 3) inventory, \$10,870.

The general fund is the operating fund of the City. At the end of the current fiscal year, unreserved fund balance of the general fund was \$2,769,282, while total fund balance reached \$3,462,429. As a measure of the general fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents 19.58% of total general fund expenditures and other financing uses, while total fund balance represents 24.48% of that same amount.

The fund balance of the City's general fund increased by \$27,383 during the current fiscal year.

Proprietary funds. The City's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail.

Unrestricted net assets of the Electric operation at the end of the year amounted to \$13,905,982, and those from the Water operation amounted to \$(29,390). The increase in net assets for Electric funds was \$745,717 and the decrease in net assets for Water funds was \$675,000, respectively. Other factors concerning the finances of these two funds have already been addressed in the discussion of the City's business-type activities.

General Fund Budgetary Highlights

There were no differences between the original and the final departmental budgets.

During the year, however, revenues exceeded budgetary estimates and expenditures were less than budgetary estimates, thus eliminating the need to draw upon existing fund balance.

Capital Assets and Debt Administration

Capital assets. The City's investment in capital assets for its governmental and business type activities as of June 30, 2007, amounts to \$77,474,436 (net of accumulated depreciation). This investment in capital assets includes land, land improvements, buildings and improvements, distribution systems, machinery and equipment, park facilities, sewer lines and roads. The total increase in the City's investment in capital assets for the current fiscal year was 7.40% (10.0% increase for governmental activities and 6.34% increase for business type activities).

Major capital asset events during the current fiscal year included the following:

- The city acquired land which will require demolition and other related improvements for \$1,899,000.

- Construction began on various Electric and Water projects; construction in progress as of the close of the fiscal year had reached \$15,202,000.
- Various system additions and improvements were completed in the Electric and Water Departments at a cost of \$2,673,691.

City of Groton Capital Assets						
(net of depreciation)						
	Governmental activities		Business-type activities		Total	
	2007	2006	2007	2006	2007	2006
Land and land rights	\$2,737	\$2,737	\$1,986	\$1,986	\$4,723	\$4,723
Construction in progress	1,899	-	15,202	13,775	17,101	13,775
Land improvements	464	493			464	493
Buildings and improvements	5,849	5,971	4,510	4,693	10,359	10,664
Distribution systems			30,471	28,726	30,471	28,726
Machinery and equipment	651	623	1,907	1,669	2,558	2,292
Vehicles	2,093	2,043	146	143	2,239	2,186
Infrastructure	9,559	9,279		-	9,559	9,279
Totals	\$23,252	\$21,146	\$54,222	\$50,992	\$77,474	\$72,138

Additional information on the City's capital assets can be found in Note III.C.

Long-term debt. At the end of the current fiscal year, the City had total net bonded debt outstanding of \$33,097,344. Of this amount, \$5,140,199 comprises debt backed by the full faith and credit of the City and \$27,957,145 is Electric and Water debt for which the City is liable in the event of default by the Electric and Water Departments.

City of Groton Outstanding Debt						
General Obligation and Revenue Bonds						
	Governmental activities		Business-type activities		Total	
	2007	2006	2007	2006	2007	2006

General obligation bonds Total	\$5,140	\$6,001	\$27,957	\$30,231	\$33,097	\$36,232
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The City's total debt decreased by a net of \$3,134,359 (8.7%) during the current fiscal year.

The City maintains an "AA-3" from Moody's for general obligation debt.

State statutes limit the amount of general obligation debt a governmental entity may issue to 7 times total tax collections including interest and lien fees and the tax relief for elderly freeze grant. The current debt limitation for the City is \$36,507,401, excluding the Electric and Water Departments' debt, which is significantly in excess of the City's outstanding general obligation debt.

Additional information on the City's long-term debt can be found in Note III.F.

Economic Factors and Next Year's Budgets and Rates

- The unemployment rate for the City is currently 4.4%, which is the same rate of a year ago. This compares favorably to the state's average unemployment rate of 4.6% and the national average rate of 4.5%.
- Inflationary trends in the region compare favorably to national indices.

All of these factors were considered in preparing the City's budget for the 2008 fiscal year.

During the current fiscal year, unreserved fund balance in the general fund increased by \$27,383. The City has appropriated \$659,538 of the 2007 fiscal year unreserved fund balance for spending in the 2008 fiscal year budget. It is intended that this use of available fund balance will avoid the need to raise taxes or charges during the 2008 fiscal year.

Requests for Information

This financial report is designed to provide a general overview of the City's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Finance Director, Anthony B. Timpano, City of Groton, 295 Meridian Street, Groton, CT 06340.