

# Mount Kemble Lake



## WATER SYSTEM PROJECT

1/24/13

# Announcement of Water Company Bids

- The Lakeshore Company has received two bids to:
  - Purchase its water company
  - Supply water to the MKL community
- Board established a Water Committee (Barrett, Coulter, Dwyer, Godfrey, Krizko, Kuhn) to:
  - Learn & educate about Commercial Water Companies (CWCs)
  - Obtain input from the MKL community
  - Evaluate bids
  - Advise the board on a course of action
  - The activities of the WC are the Water System Project (WSP)

# Meeting Purpose

- Inform community of the WSP
- Obtain feedback and input
- Topics to be covered:
  - Background on the Proposal
  - Rates & Billing
  - Profile of Bidders
  - Bid details
  - Next Steps
  - Sell vs. Hold considerations
  - Q&A
  - Discussion
- Caveats:
  - Due diligence still proceeding.
  - Dollar amounts are estimated and rounded.
  - Negotiations not begun

# Origins of WSP

## Financial Committee (FC) Project (2009-2011)

- FC considered asset sales
  - Water System a potential asset for sale
  - Sale would provide revenue AND reduce future investment needs
- Preliminary discussions
  - Several CWCs contacted
  - Some evaluated but declined to bid
  - Aquaamerica (Aqua): “maybe in future”
- FC dropped idea:
  - No serious interest (at that time)

# Recent History of WSP (2012)

## Post FC Funding Project

- Aqua expresses interest
- Lakeshore pursued discussions
  - With Aqua
  - Contacted 6 other CWCs
- Bids tendered by:
  - Aquaamerica, Inc. (Aqua)
  - Middlesex Water Company (MWC)
    - Bid withdrawn on January 2, 2013 due to:
      - the small size of the transaction
      - more pressing priorities in 2013

# Sale Implications

- Aqua becomes owner, responsible for:
  - Investment, planning and operations
- Aqua:
  - Has access to its equipment
    - Lot ownership retained by Lakeshore
  - Repairs piping under Lakeshore roads
    - Must restore roads upon completion
- Lakeshore is paid for transfer of ownership
- Aqua would charge for water service

# How are Rates Set/Changed by CWCs?

- CWCs regulated in NJ via:
  - BPU for rate approval
  - DEP for operations
- CWC rates based on reasonable & necessary:
  - Rate of Return on capital investments
  - Operating expenses
- CWCs incented to make reasonable capital investments
  - Unreasonable investments disallowed

# “Averaging” Effect

- Same rate for entire NJ customer base
  - Rates published in a “tariff” (approved by BPU)
  - All expenses in NJ system used to establish NJ rates
- Like an insurance pool - System wide income is used for:
  - Repairs
  - Upgrades



# Billing

- Meters at each residence & Association Venues
  - Residents billed directly by CWC
  - Billing based on usage
  - MKL dues reduced by amount of its savings

# Profile of Aquaamerica

Category	Aqua (NYSE: WTR) <a href="http://www.aquaamerica.com">www.aquaamerica.com</a>
Households Served	3 Million
NJ Households Served (Rate Base)	56,000
Operations In:	PA, OH, NJ, NY, NC, IL, TX, FL, IN, VA, GA
Annual Operating Revenue	\$700 Million

# Highlights of Bid

Details available, negotiations not yet conducted

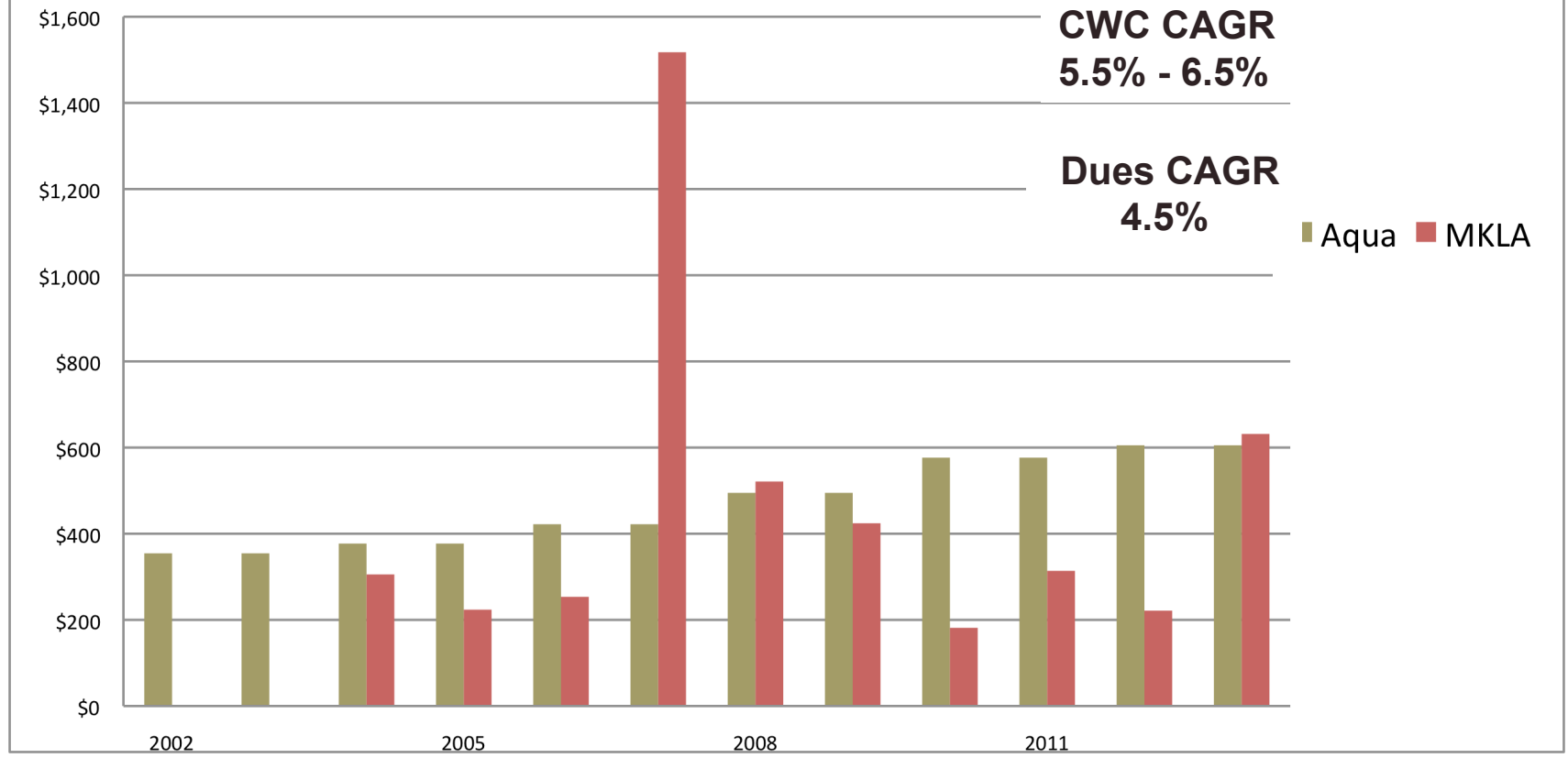
Category	Aqua
Purchase Price Offer	\$97,000
Proposed Year 1 Investment	\$100,000
5 year Improvements, as needed	<ol style="list-style-type: none"><li>1) Meter Installation</li><li>2) Curb Box Installation</li><li>3) Monitoring devices/ autodialer</li><li>4) Back-Up Power Generator</li><li>5) Well Improvements</li><li>6) Chlorine analyzer &amp; chart recorder</li><li>7) Main Repair/Replacement</li><li>8) Valve Repair/Replacement</li></ol>

# Estimated Cost Comparison for Residents

(assumes average of 250 gals/day/residence)

Options	Average Annual Cost						
MKLA	<table><tr><td>Operating Expenses</td><td>\$260</td></tr><tr><td><u>Improvements</u></td><td><u>+ \$210</u></td></tr><tr><td>Total</td><td>\$470</td></tr></table>	Operating Expenses	\$260	<u>Improvements</u>	<u>+ \$210</u>	Total	\$470
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Total	\$470						
Aqua	<table><tr><td>Average Household</td><td>\$600</td></tr><tr><td><u>Sale value per house</u></td><td><u>- \$40</u></td></tr><tr><td>Total</td><td>\$560</td></tr></table>	Average Household	\$600	<u>Sale value per house</u>	<u>- \$40</u>	Total	\$560
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# History of Annual Cost per Household



Annual Cost  
Aqua based on 250 gal/day

## MKL Responsibilities Eliminated in a Sale

- Capital projects move from LCRF to Aqua
  - Near-term anticipated costs (e.g., pump replacement)
  - Eventual tank replacement
  - Unknown repairs (e.g., pipe replacement)
  - Upgrades to system (e.g., backup generator)
  - Future regulatory mandates
- Operations move to Aqua
  - Coordination with current licensed operator (AGRA)
  - Data collection (work now done by VSAs)
  - Interface with NJDEP
  - Coordination of repairs (e.g., leaks)

# Uninsured Risks Discovered During WSP

- WC has uncovered some uninsured risks
- Risks are low probability but real
- These risks are now being analyzed by the WC
  
- The risks we are going to mention would all be assumed by Aqua.
  - MKL
    - spreads risks over 95 residents.
  - Aqua
    - spreads risks over tens of thousands of customers
    - has insurance

# Un-insured Risks Discovered During WC Work

- Product Liability – someone drinks our water, becomes ill, and sues charging “contaminated water”.
- Continuation of Service – an outage, e.g.
  - both pump houses damaged
  - tree falls on water tanks
  - aquifer become contaminated

Requires MKL to monitor wells and/or truck-in water



## Next Steps in the WSP (timeframes approximate)

- Complete due diligence (February)
- WC presents recommendations to Board (March)
- Inform meetings
  - WC Present findings
  - Get more input
- Should WSP continue, Special Meeting to Vote on Sale (April)
- If members approve sale
  - Inform CWC, conduct final negotiations, sign contract (Spring)
  - CWC to seek BPU approval
  - Sale completed, CWC takes over operations (early 2015?)

# Sell or Hold? - Costs & Risks

SELL	HOLD
Long term professional management & hotline	VSA, a part time volunteer VP & Agra (usually available)
Eliminates exposure re repairs, upgrades, new regulations	LCRF, dues & one time assessments
Rates are reviewed and set by the BPU	We control our own costs by controlling our level of investment
Provides upfront cash & reduces draw on our LCRF	All our identified long term projects are covered in current funding plan
CWC incented to bring our system up to industry standards better system	We're incented to "make it work" as long as possible less cost, less disruptive activity

# Sell or Hold? – Quality of water

SELL	HOLD
Water specifications set by NJDEP	
Eliminates liability risk of loss of water or contamination, or impairment	We've never had a problem in the past. Loss of water not insurable.
Service issues – small and large – are CWC 's problem and built into their rate base	We control rate of response, level of effort, and pay for same.
<p style="text-align: center;">On a big outage: Are we a priority?</p>	<p style="text-align: center;">On a big outage: Can we muster resources faster than a CWC can?</p>
Monitoring & Proactive Planning for DEP Regulations done by CWC	Implementation of DEP regulations as required.

## Some Qs & As

- Q: Can water from MKL wells be sold to non-MKL customers?
- A: From Aqua: “If requested by a government authority in the event of some emergency on a limited basis. Otherwise, your system does not have a sufficient abundance of excess water, nor the pumping capacity nor storage capability, and trucking water for any extended period of time would be cost prohibitive.”
  
- Q: Are the water quality standards a buyer is held to the same as are currently in force at MKL?
- A: Yes
  
- Q: Will the target chlorination level be the same as is currently in effect at MKL?
- A: Yes. The regulations for chlorine levels are the same for all size water companies.

## Some Qs & As

- Q: How can the buyer make money on an old system like ours?
- A: As monopolies, utilities:
  - Are guaranteed profitability.
  - Work on a “cost + built-in-profit” model
  - Have an incentive to invest because:
    - built-in-profit is a percentage of such investment
    - More investment means more profit
- Q: What keeps utilities from unnecessary investments?
- A: Unnecessary investments can be disallowed.

## Some Qs & As

- Q: What control will MKLA have over water operations?
- A: Like other utilities that serve MKL
  - Aqua will control operations.
  - Complaints can be directed to their hotline, the DEP or the BPU.
  - MKLA will coordinate street closings with Aqua.

## Some Qs & As

Q: What will happen to the sale proceeds?

A: Here are some possibilities:

#1 – Distribute to Lakeshore shareholders

#2 - Reduce dues until proceeds are "used up"

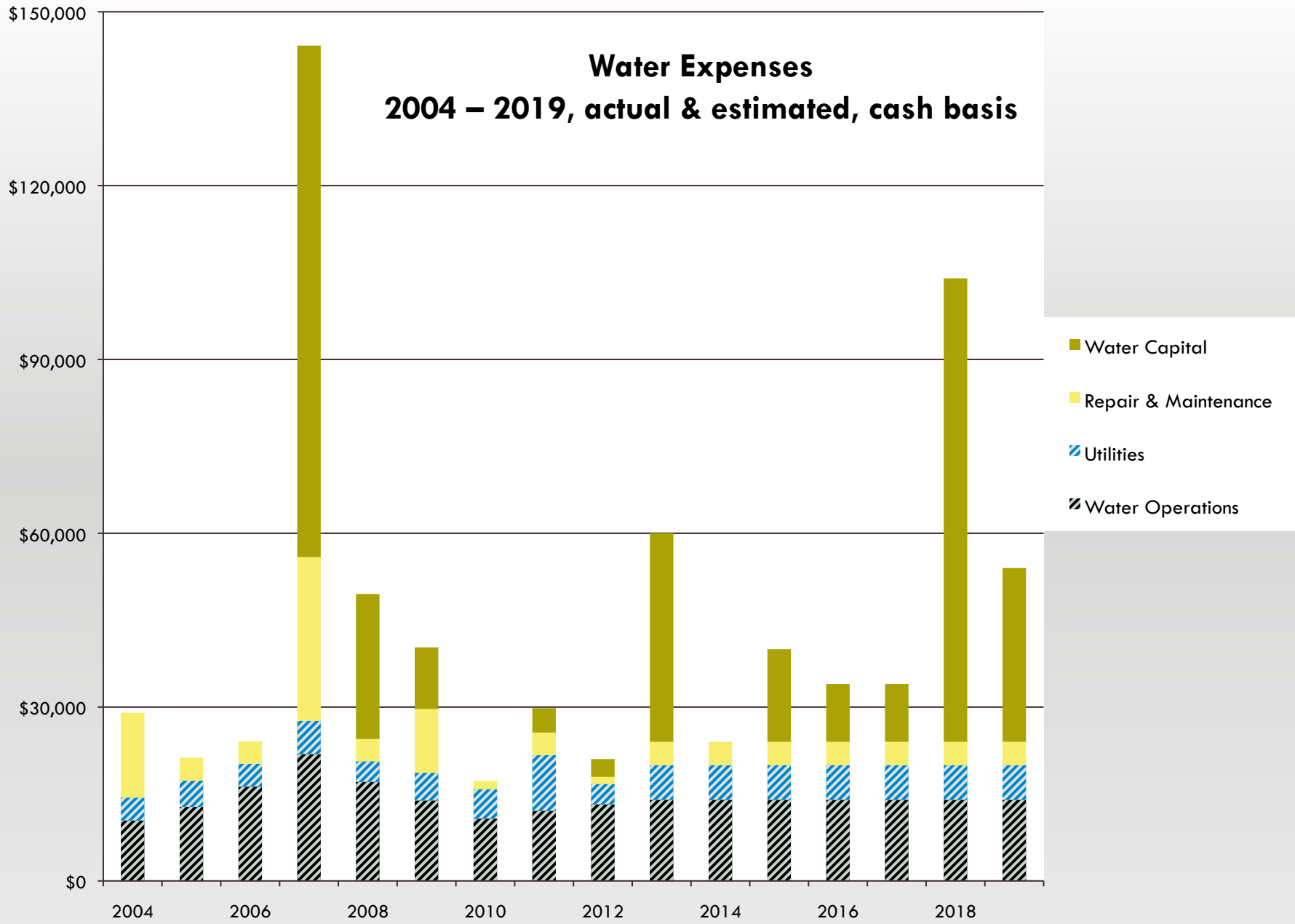
#3 - Put proceeds into long term capital fund

Other Suggestions?

# Discussion



# Backup Slides



# Estimated Volunteer Effort on Water Company

122 hrs/yr – VSA measurements (20 mins/day)

52 hrs/yr – Management (1 hrs/week)

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174 hrs/yr (23 work days/yr)

# MKLA Current Capital Spending Plan Water System Improvement Projects

	2013	2014	2015	2016	2017	2018	2019
<b>Total for Water System</b>	<b>\$38,000</b>	<b>\$2,000</b>	<b>\$18,000</b>	<b>\$12,000</b>	<b>\$12,000</b>	<b>\$82,000</b>	<b>\$32,000</b>
Replace pump in PH1			10,000				
Replace chlorine pumps repipe PH1	1,000		1,000				
Replace pump in PH2					10,000		
Paint inside of vert. tanks repaint outside tanks			5,000	10,000			
repair leaking pipes	2,000	2,000	2,000	2,000	2,000	2,000	2,000
Alpine Main						80,000	
Dedicated generator	35,000						
LTE & LTW steel pipes							30,000

# How Typical Businesses Make Money

- Have a product people want to buy
- Be able to offer it at a competitive price
- Raise enough money to get started
- Sell it

$$\text{Profit} = \text{Price} - \text{Costs}$$

To increase your profit, try to raise prices and/or lower costs.

# How Regulated Utilities Make Money

- Get permission to exclusively sell in a region
- Raise enough money to get put “plant” in service
- Get your ROI and Prices approved by the BPU

$$\text{Profit} = \text{ROI} \times \text{Investment}$$

$$\text{Price} = \text{Costs} + \text{Profit}$$

To increase your profit, try to invest more in your plant.

# An Example: Commercial Water Company

## Annual Costs:

Operating Costs	\$100,000	
Depreciation Costs	\$ 10,000	
<u>10% ROI (large assets)</u>	<u>\$ 5,000</u>	<u>← Profit</u>
Total Annual Costs	\$ 115,000	

## Calculation for Rates charged:

Total Annual Costs	\$115,000
<u># Customers</u>	<u>250</u>
Annual Customer Bill	\$460

# Why Is MKL a Purchase Target?

Typical businesses take on new customer if  
**Profit** is same or higher than average customer

Regulated utilities take on new business if  
**Investment** is same or higher than average customer