

Mount Kemble Lake



WATER SYSTEM PROJECT

Inform Meeting
December 12, 2012

Updated 12/14/12 to Reflect
Comments from 12/12/12 Meeting

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
- Now serious bids from:
 - Aquaamerica, Inc. (Aqua)
 - Middlesex Water Company (MWC)

Sale Implications

- CWC becomes owner, responsible for:
 - Investment, planning and operations
- CWC:
 - 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
- CWC 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 Options

- Option #1: Meters at each residence
 - Residents billed directly by CWC
 - Billing based on usage
 - MKL dues reduced by amount of its savings
- Option #2: Meters only at the community pumps
 - Aggregate amount water pumped billed to MKLA
 - MKLA pays CWC out of dues
 - Resident dues adjusted to reflect
 - rate increases
 - changes to total water consumption
 - Only Middlesex interested in offering this option

Profile of Bidding Companies

Category	Aqua (NYSE: WTR) www.aquaamerica.com	Middlesex (NASDAQ: MSEX) www.middlesexwater.com
Households Served	3 Million	450 Thousand
NJ Households Served (Rate Base)	56,000	60,000
Operations In	PA, OH, NJ, NY, NC, IL, TX, FL, IN, VA, GA	NJ, DE
Annual Operating Revenue	\$700 Million	\$100 Million

Highlights of Bids

Details available, negotiations not yet conducted

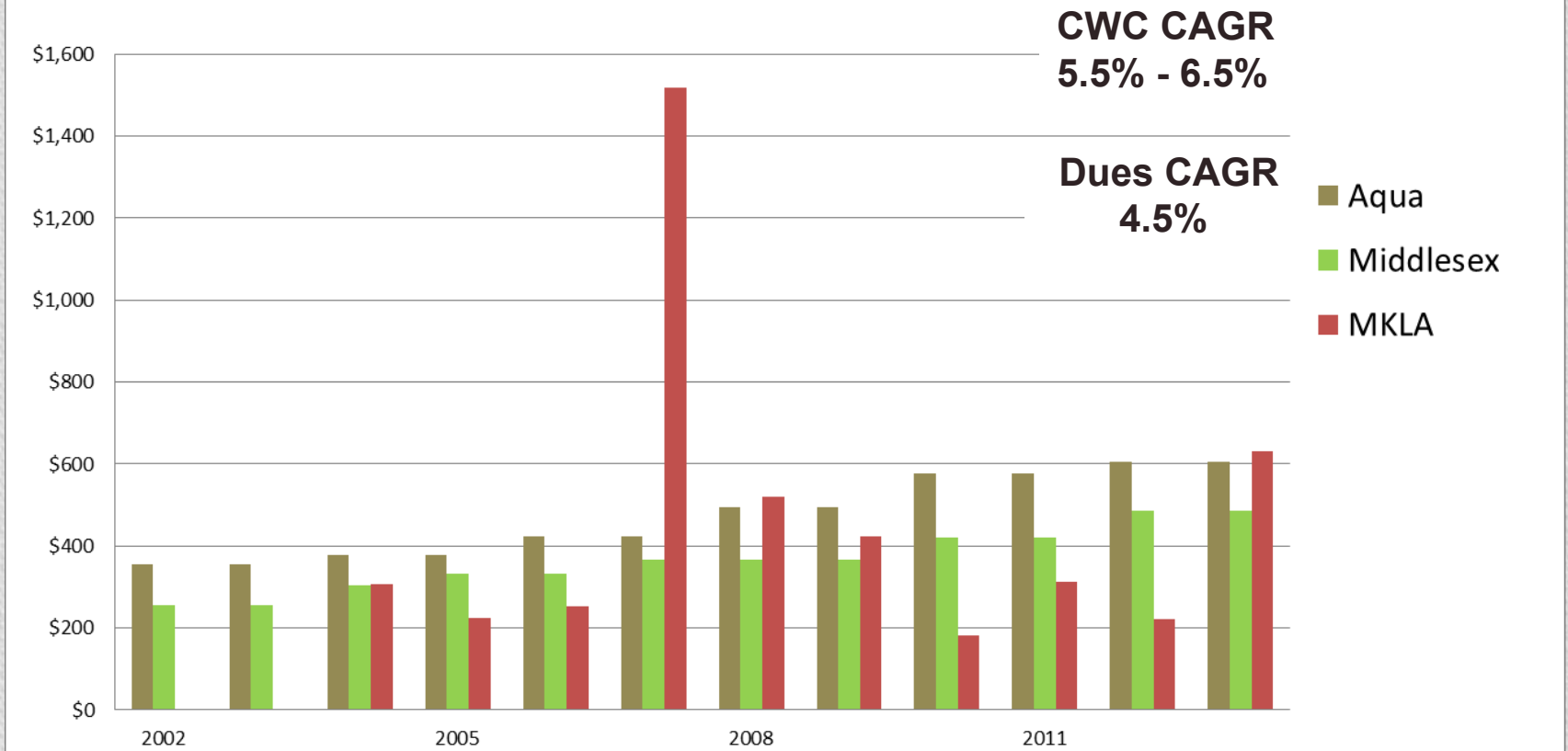
Category	Aqua	Middlesex
Purchase Price Offer	\$97,000	\$85,000
Proposed Year 1 Investment	\$100,000	\$100,000
5 year Improvements, as needed	<ol style="list-style-type: none">1) Meter Installation2) Curb Box Installation3) Monitoring devices/ autodialer4) Back-Up Power Generator5) Well Improvements6) Chlorine analyzer & chart recorder7) Main Repair/Replacement8) Valve Repair/Replacement	<ol style="list-style-type: none">1) Meter Installation2) Curb Box Installation3) Monitoring devices/ autodialer4) Back-Up Power Generator5) Well Improvements6) Chlorine analyzer & chart recorder7) Main Repair/Replacement8) Valve Repair/Replacement

Estimated Cost Comparison for Residents

(assumes average of 250 gals/day/residence)

Options	Average Annual Cost						
MKLA	<table border="0"> <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
Operating Expenses	\$260						
<u>Improvements</u>	<u>\$210</u>						
Total	\$470						
Aqua	Individual \$600						
Middlesex	Individual \$600						
	Community \$490						

History of Annual Cost per Household



Annual Cost
 Based on 250 gal/day
 Aqua based on individual meters
 Middlesex based on community metering

MKL Responsibilities Eliminated in a Sale

- Capital projects move from LCRF to CWC
 - 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 CWC
 - 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
- The risks we are going to mention would all be assumed by a CWC.
 - MKL
 - spreads risks over 95 residents.
 - CWC
 - spreads risks over hundreds 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”.
 - Quote for insurance: \$40K/yr (\$420/yr/residence) for \$5M, \$25K deductible
- Continuation of Service – an outage, e.g.
 - both pump houses damaged
 - tree falls on water tanks
 - aquifer become contaminatedRequires MKL to monitor wells and/or truck-in water.
 - Quote for insurance: \$80K/yr (\$840/yr/residence)

Next Steps in the WSP (timeframes approximate)

- Complete due diligence (January)
- WC presents recommendations to Board (late January)
- Inform meetings
 - WC Present findings
 - Get more input
- Should WSP continue, Special Meeting to Vote on Sale (March)
- 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 Middlesex: “MWC does not want to have any restrictions regarding the use of its water supply beyond those required by regulatory agencies. The NJDEP would have the approval authority for using Lakeshore water in other areas. The HOA could always express their concerns to the NJDEP.”
 - There are uniform standards for delivery throughout the state.
 - MSW also indicated there is no financial rationale to sell water from MKL
- 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
 - The CWC will control operations.
 - Complaints can be directed to their hotline, the DEP or the BPU.
 - MKLA will coordinate street closings with the CWC.

Some Qs & As

Q: What will happen to the sale proceeds?

A: Here are some possibilities:

#1 – Distribute to Lakeshore shareholders

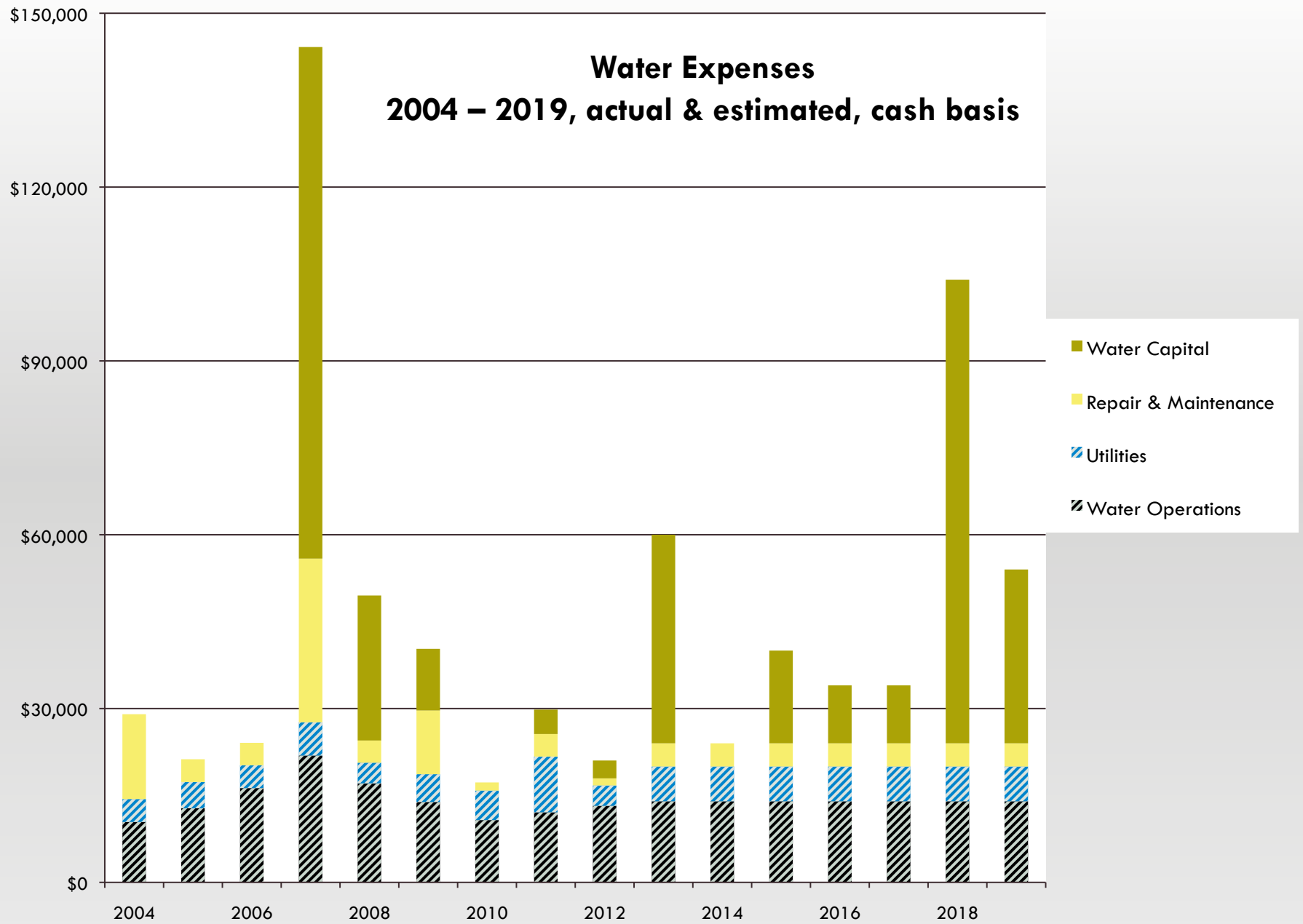
#2 - Reduce dues until proceeds are "used up"

#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)

174 hrs/yr (23 work days/yr)

MKLA Current Capital Spending Plan Water System Improvement Projects

	2013	2014	2015	2016	2017	2018	2019
Total for Water System	\$38,000	\$2,000	\$18,000	\$12,000	\$12,000	\$82,000	\$32,000
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

Pump House #1



Pump House #2



Water Storage Tanks

