

RECOMMENDATION FOR USE OF SALE PROCEEDS

Point 3 of the committee's charter is to "make recommendations for the use of sale proceeds." The offered purchase price is \$97,000. Because of offsetting operating losses, Lakeshore's taxes on the proceeds will be zero. Legal fees for the transaction are estimated at \$10,000, leaving net proceeds to Lakeshore of about \$87,000.

To fulfill Point 3 of its charter, the committee considered a number of alternatives, for using the \$87,000. These alternatives included:

1. Use the sale proceeds to benefit the community by using them for other capital projects or to avoid some future dues increases due to inflation in other operating costs. The Committee recognizes the attraction of this option, but considers it an entirely separate matter, i.e. any new capital projects or dues increases should be weighed on their own with appropriate input from the Board and Community, not tied into or confused with the decision regarding Aqua NJ's bid.
2. Distributing the \$87,000 in the form of a one-time dividend to Lakeshore's shareholders. This would amount to about \$915 per shareholder.
3. Investing the \$87,000 and forever using the investment's returns to pay expenses and pass the reduction in expenses on to residents in the form of reduced Association dues. (Note that dues are no longer paid to Lakeshore, but Lakeshore's reduced expenses can be passed on to Association members in the form of decreased rents that the Association pays to Lakeshore. The Association in turn can lower its dues). Assuming an investment return of 5%/yr this would amount to \$4350/yr or about \$45/yr in reduced dues per shareholder.
4. Investing the \$87,000 and use it over a specific period of time to reduce Lakeshore expenses. Our recommendation,

explained in more detail below, is to use the \$87,000 over 14 years to pay Lakeshore debt expenses, resulting in a dues reduction of \$63/yr per shareholder.

Distributing the proceeds as dividends has the attraction of immediately benefitting shareholders. However, it is tax inefficient, in that federal and state taxes would be due on them. Estimating a combined state and federal rate of 33%, taxes of \$305 would be due on the \$915, resulting in a net benefit of \$610 to each shareholder.

Points 2 and 3 are really the same basic idea. They are tax efficient in that the \$87,000 benefits the shareholders without creating income, and thus a new tax liability. They merely vary with regard to the term over which the benefit is paid, perpetuity or through 2028. Note that the longer the benefit is drawn out the less its annual value to the shareholder in earlier years. The Committee is also concerned that without a specific plan for the \$87,000, it will be consumed well before 2028.

Trying to maximize the benefit to the shareholders, make it tax efficient, having a specific plan and avoiding any dues “yo-yo” effect (dues reduced temporarily and then increased when the benefit expires), the Water Committee recommends that the proceeds of the sale be used to contribute to the payments of Lakeshore’s dam/dredge obligations uniformly over each of the semi-annual payments from 2014 through 2028. Using this approach, in 2028 the \$87,000 will be completely used up, but the cost it was being used to subsidize – the dam loan payments – will also be finished, so there will be no reason to increase dues back up.