

WATERONE 2012 BUDGET EXECUTIVE SUMMARY

2011 UPDATE

It is estimated 2011 Water Sales will be on target for budgeted revenues. Revenue deficits through August, due to more rain than average, were offset by a much dryer than normal September and October. Average water consumption per customer continues to decline. This is consistent with national trends primarily caused by less base consumption due to water saving fixtures and appliances.

New customer growth, investment income, and other income are slightly higher than budgeted in 2011 despite the slow pace of the economic recovery and historically low interest rates.

Any revenue shortfalls in 2011 are expected to be offset with savings in projected Annual Capital and O&M costs, especially with the continued careful evaluation of filling staff vacancies.

Despite revenue difficulties in 2008, 2009, 2010 and 2011, WaterOne has remained committed to funding its Annual Capital program, approximately 90% of which is for replacement of aging infrastructure or technology improvements.

In December the outstanding 2001 Bonds are to be defeased using available Master Plan Funds for a savings of approximately \$.5M. A two year repayment schedule is included in the redemption plan. The effects of this redemption can be seen in the 2012 Revenue Requirements, Debt Service, and Repayment to Master Plan sections of the Executive Summary.

2012 OVERVIEW

WaterOne is able to maintain the previously projected 4.9% rate increase despite several uncontrollable factors. Interest income projected to start to increase to more normal levels is decreased to mirror current conditions. Again in 2012 as well as future years it is necessary to lower projected customer base usage. Though changes in customer usage patterns have been recognized and projections scaled downward the last several years, deeper adjustments are still necessary to reflect usage trends. Customer growth though trending slightly up is also again reduced from previously projected levels to more closely reflect a slower than expected economic recovery. Though costs of necessary operating elements such as power, chemicals, and fuel continue to increase, these are balanced with decreases in other operating areas and with the elimination of planned additional personnel, many of which were tied to future growth.

Revenue shortfalls in 2008-2009 significantly reduced funding to Annual Capital projects. Despite these revenue shortages WaterOne remained committed to the planned replacement of aging infrastructure and technology. A three year plan was developed beginning with the 2010 budget to address the backlog. 2012 is the last year of this three-year catch-up of Annual Capital funding. However, careful evaluation of projects and current condition assessments enabled a \$1.9 million dollar reduction in Annual Capital from previous projections.

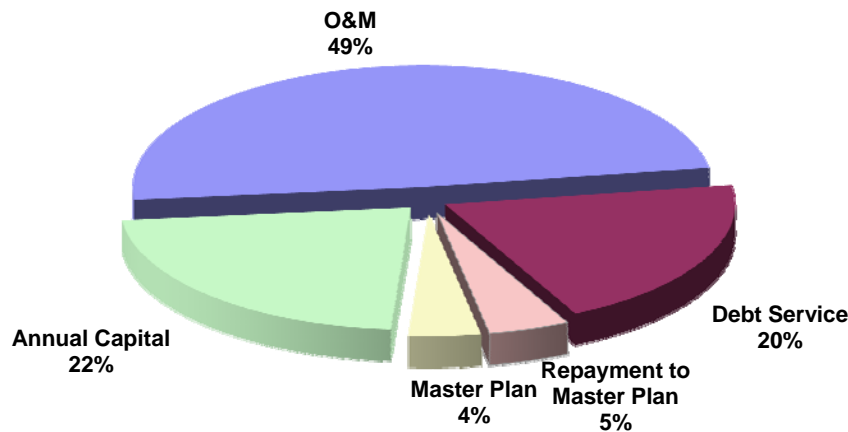
The recommended 4.9% rate increase will add \$1.77 to the typical customer's bill. Every attempt has been made to keep this increase to a minimum with pro-active adjustments to changing conditions and consistent long-range planning.

WaterOne remains financially stable, has a balanced budget for 2012 and continues to provide a safe, reliable, high-quality water supply with superior service and value.

2012 REVENUE REQUIREMENTS - \$94.7M

Projected revenue requirements for 2012 increased over the 2011 budget by \$3.5M (3.8%). \$1.7M of the increase is for Operating & Maintenance Expense which includes payroll and benefits and commodities such as power & chemicals. Annual capital decreased \$0.41M. Designated to Master Plan increased to \$4.2M. Repayment to Master Plan of \$3.7M is part of the bond defeasance plan discussed earlier.

2012 Annual Budget - \$94,717,544



Comparison between 2011 & 2012 budgets

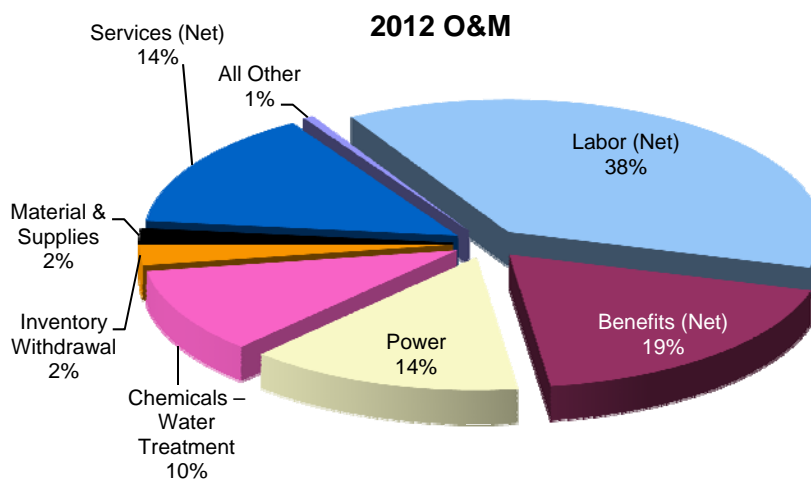
In millions

Revenue Requirement	2011 Budget	2012 Budget	\$ Inc <Dec>	% Inc <Dec>
O&M	\$44.48	\$46.20	\$1.73	3.9%
Debt Service	22.46	18.92	<3.53>	<15.7%>
Annual Capital	21.31	20.90	<0.41>	<1.9%>
Restricted	0.47	0.69	0.22	46.8%
Master Plan	2.51	4.25	1.74	69.3%
Repayment to Master Plan	0.00	3.75	3.75	NA
Total	\$91.22	\$94.72	\$3.50	3.8%

Numbers may not total due to rounding

Operations & Maintenance (O&M) Expenses – \$46.2M

O&M expenses are 49% of the 2012 budget the same as in 2011. The total O&M budget increased from the 2011 budget by \$1.7M. Payroll and benefits combined are \$0.4M of the increase. The remaining increases are primarily due to increases in power, chemicals and fuel costs. Below is the breakdown of the significant 2012 O&M accounts and their changes.



In millions	2011 Budget	2012 Budget	\$ Inc <Dec>	% Inc <Dec>
Labor (Net)	\$16.89	\$17.42	\$0.53	3.1%
Benefits (Net)	8.65	8.56	<0.09>	<1.0%>
Power	5.84	6.53	0.69	11.7%
Chemicals – Water Treatment	4.45	4.84	0.39	8.7%
Inventory Withdrawal	0.92	1.14	0.22	24.2%
Material & Supplies	0.78	0.83	0.05	6.1%
Services (Net)	6.62	6.65	0.03	0.5%
All Other	0.32	0.24	<0.09>	<26.4%>
Total	\$44.48	\$46.20	\$1.73	3.9%

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Labor

Net labor includes:

- The annual true-up of the 2012 base
- A net increase of 6 positions
- A 3.5% market/merit increase
- Overtime
- Transfer to capital

Planned New Personnel budgets for both 2012 and the five-year plan were re-evaluated as part of the budget process. All planned new positions were judged for operational necessity or matched to future growth projections. As a result six full-time positions are requested in 2012, an Engineering Tech I in the Production Division and five crew positions in the Construction and Maintenance Department. All six positions were temporarily eliminated

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because of budget constraints. All other planned positions were either completely eliminated or moved to subsequent years in the five-year plan. The \$526,340 (3.1%) net labor increase in 2012 is primarily due to market/merit increase.

Benefits – All Benefits, including transfers, decreased \$87,582 or 1.0% for 2012. The majority of benefit expenditures are related to health insurance and pension costs which both increased moderately in 2012. The increases are offset by reductions in worker's compensation and unemployment insurance premiums as well as an increase in benefit costs transferred to capital. Health insurance premiums remain unchanged for another year without any reduction in benefits or additional costs to employees. The budget continues to include funding for Other Post Employment Benefits (OPEB).

Power - The power budget is increased \$685,765 over 2011 primarily due to a planned increase by the Board of Public Utilities (BPU), WaterOne's power provider for source and treatment.

Chemicals – An increase of \$386,637 in the 2012 chemical budget is a combination of factors including an increase in chemical prices, and changes in the type and quantity of chemicals used at the different treatment facilities.

Inventory Withdrawals - The primary driver for the \$223,036 increase is the rise in fuel costs budgeted at \$2.75 per gallon in 2011 to \$3.82 in 2012.

Materials & Supplies – A net \$47,713 increase in this account is caused primarily by true-ups to custodial, maintenance, and laboratory supplies. The increase was minimized by reductions in the use of outside lab testing and a managed downward trend of fleet costs.

Services – Most services accounts are budgeted below 2011. Programs for customer communications enhancements and a study on blue-green algae are new in the 2012 budget.

Debt Service - \$18.9M

The Debt Service for 2012 decreased \$3.53M (15.7%) from 2011 per the planned Debt Service Schedule and the early defeasance of the 2001 Bonds.

Annual Capital - \$20.9M

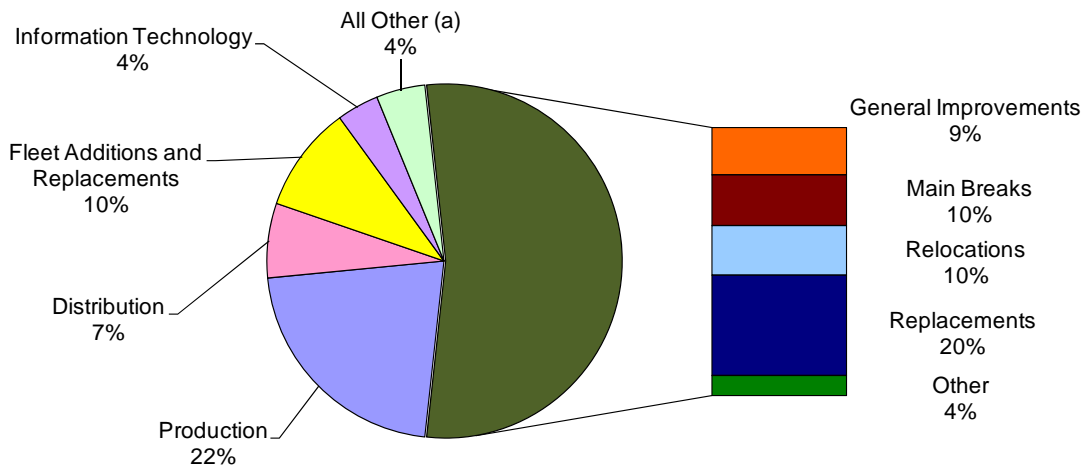
The Annual Capital budget for 2012 is a \$0.4M (1.9%) decrease from the 2011 budget. Ninety percent of the total budget is used for maintaining current facilities and equipment. Repair and replacement is continuously evaluated to determine the proper time to repair versus replace. Replacement needs will vary from year to year and decreased slightly in 2012. The projects presented in the 2012 budget have been developed based on the assumption that all previous year's approved and authorized projects will be complete or have funding designated for them at the end of 2011.

The Transmission & Distribution (T&D) component of the Annual Capital budget has increased from 2011 by \$1.37M to \$11.17M. WaterOne continues to execute its Asset Management Plan developed in 2003 and updated in 2009. The plan enables the replacement of aging infrastructure when it results in the lowest life-cycle cost for a particular asset. The increase in 2012 is primarily for distribution main replacements and transmission main assessment and repair. Other T&D funds are for main breaks, relocations, and general improvements.

Annual Capital, not including T&D, has decreased from 2011 by \$1.78M to \$9.73M. These capital requests are used to replace obsolete or worn-out equipment, purchase new equipment and technology, and make improvements to existing capital assets. Approximately \$7.4 (76%) is for replacements while \$2.3M (24%) is for new purchases.

The capital requests for Information Technology decreased for 2012 because the upgrade to the SAP system project was a large project in the 2011 budget.

Percent of Total Budget by Function



In Millions	2011 Budget	2012 Budget	\$ Inc <Dec>	% Inc <Dec>
Transmission & Distribution	\$9.80	\$11.17	\$1.37	14.0%
Production	3.91	4.54	0.64	16.4%
Distribution	1.50	1.42	<0.08>	<5.1%>
Fleet	2.36	2.03	<0.33>	<13.8%>
Information Technology	3.09	0.80	<2.29>	<74.1%>
All Other	0.66	0.93	0.27	41.7%
	\$21.31	\$20.90	<\$0.40>	<1.9%>

Numbers may not add due to rounding

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Restricted – \$0.7M

The Restricted category consists of Master Plan investment income, required funding to certain reserves specified by the bond covenants, and negative cash flow. Projected interest rates and projected revenue requirements both size and timing will effect this budget category.

Master Plan – \$4.2M

The Designated Funding for Master Plan recognizes that existing customers benefit from the projects in Master Plan so should contribute some funding through water rates. The goal is for at least 2% of total revenue to be designated to Master Plan from the annual budget. Due to revenue deficits the past several years this has not been possible. The 2012 budget of \$4.2M achieves the 2% plus an additional \$2.4M. This “pay as you go” approach will reduce the amount of future bond issues.

Repayment to Master Plan – \$3.7M

The \$3.7M repayment is the first of two years of repayments for the 2001 bond defeasance as discussed earlier under Debt Service.

2012 PROJECTED REVENUES - \$94.7M

2012 revenues are projected to increase by \$3.5M or 3.8% over 2011. The 2012 rate increase is needed primarily because of the reduction in expected revenues and cost increases. The major revenue drivers are:

- The slow pace of new customer growth now projected at 600 for 2012 instead of the 700 forecast for 2012 in late 2010.
- Conservation and declining base consumption in all classes with large commercial users showing the greatest decline in water use.
- 2012 Investment Income is budgeted at an interest yield of 0.25% compared to the 1.0% originally projected.

As previously discussed, revenue requirements were decreased where possible to ensure WaterOne maintained the forecasted rate increase of 4.9%. The recommended rate increase adds \$3.5M in additional revenue.

Comparison of Revenues

In Millions

	2011 Budget	2012 Budget	\$ Inc <Dec>	% Inc <Dec>
Water Sales	\$89.67	\$93.11	\$3.44	3.8%
Misc. Revenues	1.36	1.40	0.05	3.3%
Investment Inc.	0.19	0.21	0.02	10.5%
Total	\$91.22	\$94.72	\$3.50	3.8%

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IN CONCLUSION

Despite uncooperative weather, the slowdown in customer growth, reduction in usage per customer, and the low investment yields, WaterOne’s financial position continues to be strong. Even with the tough choices necessary to face the current fiscal challenges, WaterOne’s Board and staff remain committed to fulfilling our vision of *Setting the Standard for Utility Excellence*.