

**WATERONE 2010 PROPOSED BUDGET
EXECUTIVE SUMMARY**

2009 UPDATE

There were numerous challenges that were successfully overcome in 2009. The continuing economic slowdown has reduced customer growth for the past three years. The cool, wet weather in 2008 and 2009 further reduced water sales revenues, and the low rate of return on investments added to the revenue challenges. In addition, during 2008 both of WaterOne's bond surety providers failed to maintain their triple-A ratings. The rating downgrades forced WaterOne to decide how to provide additional appropriate security for the bondholders.

To solve these revenue and funding challenges, staff made decisions that reduced expenditures without harming the delivery of essential services. Full-time and part-time vacant positions were not filled. All other expenditures, both operating and capital, were frozen or slowed except for those that were considered mission critical. WaterOne decided to fund the bond reserves, which were no longer triple-A insured, with cash from long-term capital reserves (Master Plan) as well as the Rate Stabilization Reserve.

2009 also included the successful refunding of three series of outstanding bonds for a savings of \$3.0M over the life of the bonds. Standard & Poor's reaffirmed the AAA/AAA ratings and Moody's reaffirmed the Aaa/Aa1 ratings on WaterOne's first lien and second lien bonds respectively. In addition to the savings, the series 2009 bonds also included revisions to the bond covenants that continue to provide appropriate security for the bondholders while increasing the Board's and staff's flexibility to prudently manage the utility.

2010 OVERVIEW

WaterOne's long range financial plan provides the framework for establishing rates and charges that support the budget requirements. In constructing a current year budget, WaterOne makes adjustments based on the changing economic environment. In 2009, a 4.9% rate increase was projected for the 2010 fiscal year. Though the proposed rate increase remains 4.9%, the drivers of the 2010 budget are very different than first forecast in 2009.

The 2010 rate increase is needed primarily because of a reduction in expected revenues along with a scheduled increase in debt service. 2010 projected revenues fell due to slower customer growth, fewer projected gallons sold per large commercial customer, and lower investment income. Total revenue for fiscal year 2010 is \$5.0M less than what was forecast in 2009.

The proposed 2010 rate increase of 4.9% will increase the typical residential customer bill by \$1.65 per month.

Communities served by WaterOne, though certainly affected by the slowing economy, have not experienced the deep economic declines seen in other parts of the country and are showing some initial signs of recovery. Sound fiscal policies have guided WaterOne through these economically challenging times; as a result, WaterOne remains in stable financial condition.

WaterOne is pleased to present, to its rate payers, a balanced budget that is consistent with previous projections, has been adjusted based on current economic conditions, and does not sacrifice the quality of our product or our service.

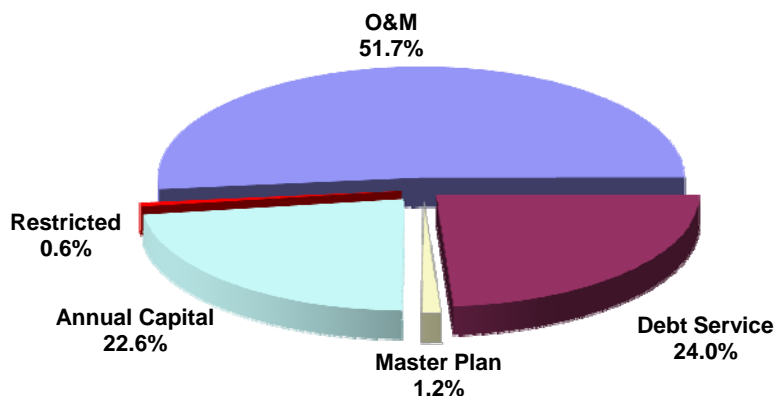
EXECUTIVE SUMMARY

2010 REVENUE REQUIREMENTS - \$88.3M

Proposed revenue requirements for 2010 increased over 2009 by \$1.9M (2.2%). Debt service is increasing based on previously scheduled increases in currently outstanding bonds. O&M is decreasing by \$0.8M and Annual Capital is increasing over 2009 levels by only \$0.4M due to other budget constraints.

- In 2009, Operating and Maintenance (O&M) expense was expected to increase 6.2% in fiscal year 2010. O&M is now proposed to decrease 1.6% in 2010.
- In 2009, Annual Capital was expected to increase 6.3% in fiscal year 2010. Annual Capital is now proposed to increase only 1.8% in 2010.

WaterOne has a Board policy that requires the budget have a minimum debt service coverage ratio of 2.0. Once revenues are used to pay for O&M the remaining revenues are available to “cover” or pay the required debt service. One times the debt service coverage pays for the debt service itself. The remaining debt service coverage pays for Annual Capital and the funding to Master Plan. In 2010 the funds available because of this increase is \$2.8M which would normally be designated to Master Plan. However, the previously mentioned revenue shortfalls in 2008, 2009 and 2010 have created an Annual Capital backlog of \$6.6M. This backlog will be funded using the increase in the revenue requirement for 2.0 debt service coverage over the next three years.



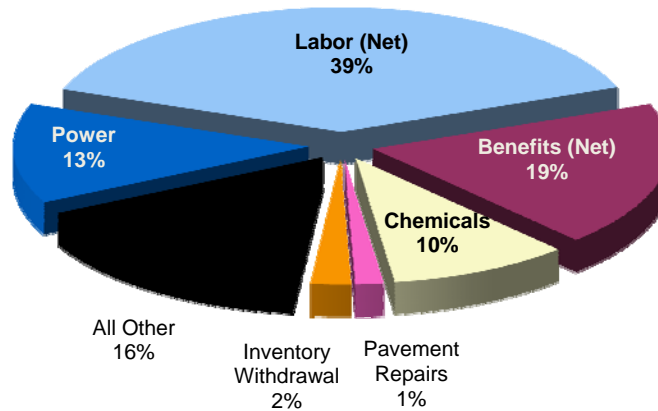
Revenue Requirement	2009 Budget	2010 Budget	\$ Inc <Dec>	% Inc <Dec>
O&M	\$46.4	\$45.6	<\$0.8>	<1.6%>
Debt Service	19.6	21.2	1.6	8.2%
Annual Capital	19.7	20.0	0.4	1.8%
Restricted	0.4	0.5	0.1	31.5%
Master Plan	0.4	1.0	0.6	151.1%
Total	\$86.4	\$88.3	\$1.9	2.2%

Numbers may not total due to rounding

OPERATIONS & MAINTENANCE (O&M) EXPENSES – \$45.6M

O&M expenses are 51.7% of the 2010 budget. The total O&M budget was reduced in 2010 by \$0.8M or 1.6% below the 2009 level. This was necessary in order to match expenditures to projected revenues and maintain the proposed 4.9% rate increase. Below is the breakdown of the significant 2010 O&M accounts.

2010 O&M



	2009 Budget	2010 Budget	\$ Inc <Dec>	% Inc <Dec>
Labor (Net)	\$17.7	\$17.6	<\$0.1>	<0.4%>
Benefits (Net)	8.2	8.6	0.5	5.8%
Power	5.9	5.9	0.0	0.5%
Beneficial Reuse	0.4	0.0	<0.4>	<100.0%>
Chemicals – Water Treatment	4.9	4.5	<0.4>	<7.2%>
Inventory Withdrawal	1.3	1.0	<0.3>	<22.5%>
Pavement Repair	0.9	0.7	<0.2>	<23.1%>
All Other	7.2	7.2	0.0	0.4%
Total	\$46.4	\$45.6	<\$0.8>	<1.6%>

Numbers may not total due to rounding

Labor

Net labor includes: 1) the annual true-up of the 2010 base, 2) a reduction of twenty-five authorized positions, 3) two additional personnel requests, 4) a 2% adjustment pool to be used for variable pay adjustments, 5) overtime, and 6) transfers to capital. The two new positions are associated with the lab and are offset by the reduction in headcount that is discussed in the Elimination section below.

Additional Personnel

The two new positions are one full-time Field Technician and one full-time Materials Technician. Both positions are in the Operations department and will work in the lab.

Eliminations

Beginning in 2008, a hiring freeze was instituted and continued into 2009 as vacancies occurred. In addition, in mid-2009, the Support Services Division was eliminated. Its positions were either reassigned to other divisions or eliminated. The 2010 personnel budget includes the elimination of 11 full time, 5 part time, and 9 temporary/summer positions and the addition of two full time positions for a net reduction of 23 positions. The total savings in 2010 are \$842,732 (\$677,649 in labor and \$165,083 in benefits).

EXECUTIVE SUMMARY**Benefits**

Benefits, including transfers, increased \$.5M or 5.8% for 2010. The benefits category is composed primarily of health insurance, defined benefit pension contributions, worker's compensation insurance, and Other Post Employment Benefits (OPEB). Pension costs increased \$455,500 (net of transfers) due to the amortization of market losses. Health insurance decreased \$241,895 due to stable premiums and the reduction in the number of employees. Worker's Compensation increased due to a slightly higher modification factor.

Power

Despite a planned 2.9% increase in the Unified Government's payment in lieu of taxes (PILOT), the Source and Transmission power costs in the 2010 budget remain close to the 2009 budget amounts. The higher PILOT was offset by lower maximum power demand costs in the first half of 2010 and shifting a portion of the more costly MO River intake power to the less expensive new Wolcott Treatment Plant.

Beneficial Reuse

This program, designed to reuse lime residuals from the treatment process, has been delayed due to budget constraints.

Chemicals

Chemical costs are projected to decrease in 2010 due to lower chemical prices and the use of membrane technology at the new Wolcott Treatment Plant which requires fewer chemicals to treat the water.

Inventory Withdrawals

The primary driver for the decrease is lower fuel costs and lower fuel usage. \$2.75 per gallon is being budgeted for 2010 versus \$4.00 in 2009. Projected fuel usage has been reduced based on recent trends and a reduction in the number of employees.

Pavement Repairs

Pavement Repair consists of the restoration of pavement, curbs, and sidewalks damaged because of transmission and distribution construction repairs. The budget is based on historical analysis which includes a trended number of main breaks and a trended cost per break. Though the number of breaks continues to increase slightly as the distribution system ages, the cost per break is expected to drop significantly as asphalt prices have dropped. Asphalt is a petroleum based product which has seen significant price declines from the prior year.

DEBT SERVICE - \$21.2M

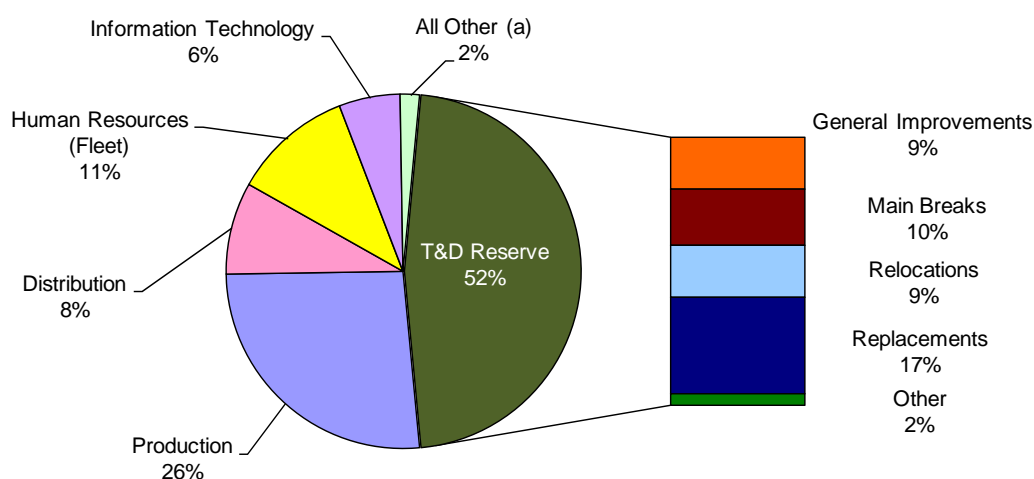
The Debt Service for 2010 increased \$1.6M (8.2%) from 2009. Debt service increased primarily because 2010 is the first year for significant principal repayment of the series 2007 bonds which provided funding for the new Wolcott Treatment Plant and related projects. The increase was offset by a reduction in debt service due to the 2009 refunding of three outstanding bond issues. While there is a new \$23M bond issue planned for 2010, the interest will be capitalized, so increased debt service will not impact the budget until 2011. The new bonds are primarily for a new laboratory which is needed to continue the production of high quality water and a new pump station needed to enhance performance in the distribution system.

ANNUAL CAPITAL - \$20.0M

The Annual Capital budget for 2010 of \$20.0M is a \$0.4M (1.8%) increase from 2009. Due to economic and weather conditions in 2008 and 2009 many Annual Capital projects have now been delayed since 2008. The projects presented in this 2010 budget have been reprioritized to include the necessary projects delayed or pushed to future years due to these budget constraints.

The Annual Capital budget is divided into two major components: Transmission & Distribution and Regular Annual Capital. The Transmission & Distribution (T&D) component of the Annual Capital budget has decreased from 2009 by \$0.4M to \$9.4M. Included in the T&D funding are funds for capitalized main breaks, relocations, replacements, and general improvements. Regular Annual Capital has been increased from 2009 by \$0.8M (7.6%). Regular Annual Capital is used to replace obsolete or worn-out equipment, purchase new equipment and technology, and make improvements to existing capital assets. Approximately \$2.4M (27%) of Regular Annual Capital is for new purchases while \$7.8M (73%) is for replacements.

Percent of Total Budget by Function



(a) "All Other" consists of all remaining Divisions, Funding to Benefit Area Refunds (Finance), and Omissions & Contingencies.

	2009 Budget	2010 Budget	\$ Inc <Dec>	% Inc <Dec>
Transmission & Distribution	\$9.8	9.4	<0.4>	<4.1%>
Production	4.2	5.3	1.1	26.2%
Distribution	1.8	1.7	<0.2>	<8.2%>
Human Resources (Fleet)	1.9	2.2	0.3	13.0%
Information Technology	1.5	1.1	<0.4>	<24.1%>
All Other	0.5	0.4	<0.1>	<20.2%>
Total	\$19.7	20.0	0.4	1.8%

Numbers may not add due to rounding

EXECUTIVE SUMMARY

RESTRICTED – \$0.5M

The Restricted category consists of Master Plan investment income, required funding to certain reserves specified by the bond covenants, and negative cash flow. Changes from year to year in Master Plan investment income is tied directly to the level of SDC and Bond funds available for investment. Both funds retain the interest they earn, so those earnings are not available to fund general operations. The 2010 restricted investment income is less than 2009 due to the closure of the 2007 bond fund since construction on the Wolcott Treatment Plant is complete. Also included in this category are funds for reserves required by section 703 of the Bond Resolution and the negative cash flow reserve. Due to reduced spending levels the 703 reserves do not need additional funding in 2010, but the negative cash flow reserve is projected to need to increase by \$0.5M over the 2009 level.

MASTER PLAN – \$1.0

The designated funding for Master Plan recognizes that existing customers benefit from the projects in Master Plan. In 2010 the major project is a new pump station to enhance service in the distribution system. As previously discussed, Master Plan funding increased \$0.6M in 2010 because funds are needed to satisfy the debt service coverage ratio policy and because Annual Capital requests have been reprioritized to start funding the backlog. Though the goal is for at least 2% of total revenue to be designated to Master Plan this will not occur until the Annual Capital backlog has been fully funded.

2010 PROJECTED REVENUES – \$88.3M

2010 revenues are projected to increase by \$1.4M or 1.7% over 2009. The 2010 rate increase is needed primarily because of a reduction in expected revenues along with a scheduled increase in debt service. The major revenue drivers are:

- The slow pace of new customer growth, now projected at 500 for 2010, has put upward pressure on rates. 2010 projected revenue decreased by \$1.6M due to the reduction in actual new customers in 2009 and the projected new customers in 2010.
- Large commercial customer consumption is declining based on historical trends. Efficiencies in business processes and conservation have reduced projected gallons sold for large commercial customers and decreased revenue by \$1.1M.
- Investment income decreased in 2010 because of low interest rates. The interest rate in 2010 is projected at 0.3% which decreased investment income by \$1.0M.

As previously discussed, revenue requirements decreased where possible to ensure WaterOne maintained the projected rate increase of 4.9%. The requested rate increase adds \$4.0M in water sales revenue.

Comparison of Revenues

Revenue Type	2009 Budget	2010 Budget	\$ Inc <Dec>	% Inc <Dec>
Water Sales	\$84.2	\$86.7	\$2.5	2.9%
Misc.	1.3	1.3	0.0	3.6%
Investment	1.4	0.3	<1.1>	<80.6%>
Total	\$86.9	\$88.3	\$1.4	1.7%

IN CONCLUSION

Despite the slowdown in customer growth, reduction in commercial gallons sold, and the low investment yields, WaterOne's financial position continues to be strong. Conservative planning has provided the financial flexibility necessary to maintain operational stability. 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*.