Hartman Consultants, LLC

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April 28, 2014

HC# 14033.02

Mrs. Amy Ahner Administrative Services Director Village of Glenview 1225 Waukegan Road Glenview, Illinois 60025

Re: Response to Fair Market Value Property Questions from Village

Dear Mrs. Ahner:

The Village acquisition team asked a few questions regarding property valuation under an Uniform Standards of Professional Appraisal Practice (USPAP) compliant full fair market value assignment. USPAP is issued by the Appraisal Standards Board of The Appraisal Foundation. This Board is authorized by Congress as the Source of Appraisal Standards and Appraiser Qualifications.

1. What types of intangible property are valued by the appraiser in a fair market value appraisal?

There are three types of property included in such an appraisal. They are real property (real estate), tangible personal property (TPP) such as pipes and pumping stations, etc., and intangible property-- which includes but is

- a. Non-physical assets
- b. Franchises
- c. Trademarks
- d. Patents
- e. Goodwill
- f. Equities
- g. Securities
- h. Contracts and contract rights
- i. Certificated or established service areas
- i. Permits
- k. Management procedures and practices
- l. Exclusive easements (performed separately with real property)
- m. Engineering studies and technical determinations as well as planning and design for facilities not constructed
- n. Time and cost of building the business
- o. Establishment of standard operating procedures (SOP's), routes, and maintenance/renewal/replacement programs
- p. Customer lists, customer data, billing, and related financial accounting
- q. Water allocations or rights

In addition to the above there are other non-physical property values.

2. What are the typical utility appraisal methods for determining intangible value for a water and sewer system?

Typically, a cost assessment for the applicable intangible items is accomplished and the amounts are totaled for the opinion. In other words, the 17 items above, and any others which may apply, are individually valued and totaled. The intangible values apply only with the cost approach and do not apply to the income or comparable sales approaches.

A second method, which takes less time, is to adopt a percentage and apply it to the cost approach as the additional value of a live plant versus a dead plant or a going concern factor. This second method is in lieu of the first method and can be compared to the first method for reasonableness. There is confusion when using the term "going concern" as to which context the term applies. "Going Concern" in terms of appraisal practice has been taken as the total enterprise, i.e. all tangible and intangible assets including business value (as stated in The Appraisal of Real Estate—Appraisal Institute various editions). In contrast, case law decisions, typical industry and banking practices treat going concern as an increment of value or a separate item, distinct from the reproduction or replacement cost of the real tangible and tangible personal property. Therefore the going concern component is added to the cost approach result in order to achieve full fair market value of the subject system. Again when either of the other two approaches is used (comparable sales or income), this component of value is already included and is not added to the result. The going concern amount is considered a part of the fair market value, in excess of the value of the physical plant (TPP) and real estate property, because the whole assembled system would be considered by a reasonable buyer and seller in setting a purchase price (see General Telephone Co. of Illinois, 29 P.U.R. 3d 369 Ill. Ct. Cl. 1959).

Each of the intangible items require careful consideration of the evaluator/appraiser and may require sub-consultants in the areas of utility engineering, management, ownership, financial, utility legal costs, regulatory rights/benefits/costs as well as specific experience in the field with prior transactions as a utility appraiser.

For either method of quantifying going concern or a cost assessment for assembly the work is not necessarily a precise calculation and involves opinion, estimates, and experience. Some cases have found that this necessary portion of value is difficult and perhaps an arbitrary task (see Appleton Water Works Co. v. Railroad Commission of Wisconsin (now the Wisconsin Public Service Commission), 154 Wis. 121, 142 N.W. 476 1913).

Historically Public Service Commissions, in the fair market value era, regularly valued the going concern component to fair market value as an added percentage or factor applied to the cost approach result of the tangible value of the property. This factor typically was between 7.5% and 25% or a 1.075 to 1.25 factor (see Indianapolis Water Co., P.U.R. Ann. 1923, D 449, Blair v. Northern States Power Co., P.U.R. 1931, A 90 (Wis. RR Comm., 1930)).

3. What experience and training do you have generally relating to a going concern factor for the NMU system?

I am not an appraiser for this assignment and can only provide consulting input considering the normal questions, my knowledge of the system, and my knowledge of the Village utility operations and management. I have owned water and wastewater utilities and have sold them. I have participated in hundreds of negotiations/transactions/cases/etc. I am a utility professional engineer registered in Illinois and I do specialize in water, sewer and other matters. I am an accredited senior appraiser with the public utility specialty. I have managed utilities on a consulting/temporary basis and assisted in the hiring and training of utility operational and management professionals. I have performed numerous rate and charge studies and certified to many revenue bond or other debt instruments. I have testified and been accepted as an expert witness at several public service commissions on rate and acquisition proceedings. With the above experience and training, I believe I can provide consulting input for consideration.

4. What are the normal questions that need to be answered?

What is the context of the transaction? It is a full fair market value context with a willing and knowledgeable buyer and seller.

How does the NMU system fit into the Aqua family of utilities? It is a relatively large and more established system similar to Aqua's Kankakee base, which could be a base link for their two divisions to the north and to the southeast. It will give the company the initial growth in customers to build from as a base link between the areas providing for efficiencies and an economy of scale.

Can the service area be expanded to include more customers? The service area is essentially built out, yet there is a provision in the Asset Purchase Agreement (APA) which provides a long term cost effective water supply for NMU and provides the ability for Aqua to purchase wholesale and resale to the other utilities surrounding the service area with a cost-effective wholesale price versus the other major wholesale provider (City of Chicago) at prices estimated to be quite favorable by mid-year 2020. Aqua could be the wholesaler of choice for water quality and price at that time. Will there be a significant additional cost to service future wholesale

No since the customer base is adjacent and the systems have emergency interconnections presently with meters etc.

What additional staff would be needed for these customers? None.

What is the rate situation? Do the present utility rates reasonably reflect fiscal reality?

Yes, not only are the rates appropriate, but in the future the cost of service will decrease do to a lowering of the wholesale water rate?

What is the maintenance program of the utility?

The Village not only had a superior maintenance program for the last 7 years, but also the renewal and replacement program has activity and efficiency tracking and performance standards. The Village has annually cleaned the sewer system, which is superior to industry standards. The water meters have all been replaced and generally the management and operations of the systems is superior to the industry. The Village has basically fixed-up the system since acquiring it and made the operations quite efficient. What is the utility's compliance with local, state and federal regulations?

The NMU system is in full compliance with all local, state and federal regulations? regulations.

What is the state of the system's technology?

It is a simple system to start with and does not need much in technology. Nonetheless, the system is completely controlled by a SCADA system. The system that has been installed operates the three re-pumping stations. There are no treatment plants.

What is the duration of the wholesale water supply agreement (WSA)? 6 years to 6/2020 and then 30 years thereafter with two additional 10-year term extensions provided for a total of 56 years.

What are the motivations of the owner/Village?

The NMU system is a satellite system, remote to the Village's central system and was an investment by the Village. The Village wishes to recapture their equity from the system, provide long-term cost-effective wholesale water service to the NMU customers, and focus on the residents within the Village limits (NMU is completely outside of the Village).

Will there be competition or cooperation?

As evidenced by the provisions of the APA and WSA their will be long term cooperation and assistance between the parties enhancing both entities.

In summary, the proposed transaction has a high level of going concern. I would advise the consideration of a 15% to 20% increment of assembly value or a 1.15 to 1.20 going concern factor.

5. Could you estimate the costs of the various intangible items for NMU?

My estimates are only advisory and should not be considered to the level of detail associated with a full appraisal.

- a. Other Non-physical assets---no estimate
- b. Franchises---no estimate
- c. Trademarks---no estimate
- d. Patents---no estimate
- e. Goodwill---As a monopoly, there is not a great deal of traditional goodwill accrued in the system. What has been accomplished are the customer education programs and customer service training and established customer practices. For an approximate 8,500 water ERC's and 3,700 sewer ERC's such programs may be valued at approximately f. Equities---no estimate
- g. Securities---All customer deposits are being transferred to the extent they exist. The payment history of the customer base is excellent. The establishment of that history which reduces risk is estimated at \$25,000.
- h. Contracts and contract rights---The ASA and the WSA as established contracts have a cost of approximately \$250,000. The future cost savings which are passed on to the customer, yet make the Aqua NMU system more competitive than Chicago by an estimated sizable margin could have a present value of some \$1,410,000 for Aqua. The Wilmette agreement benefits are great, yet the cost of the agreement and its amendments are estimated at approximately \$140,000. The Niles water supply and the Des Plaines and Morton Grove agreements would be considered at approximately \$30,000. The Metro Chicago sanitary sewer agreement and associated sewage treatment rights are taken at \$50,000.
- The established service area---The water service area is approximately 1,400 acres of developed relatively high-density projects (approximately 6 ERC's per acre gross). That water exclusive service area (though no value is given in rate case settings) in the present industry market is 2 times the typical 3 ERC's per acre. The approximate value estimate may be \$580,000.
 - The sewer service area is approximately 750 acres and is at approximately 5 sewer ERC's per acre. The approximate value estimate
- j. Permits---The IDNR water allocation and the IEPA water and wastewater permits, as well as the licenses for the system operations and communications, have an establishment cost estimated at \$80,000.
- Management procedures and practices---The records and programs that the Village will transfer and that will be used by Aqua for the NMU systems are estimated to have a value of \$35,000.
- Exclusive easements---valued with the real estate.
- m. Engineering, planning, and technical determinations---The 5-year CIP has an estimated cost of approximately \$3.5 million. At an average of 3% for that program and an equal value for other programs and information not included in the cost approach results in an estimate of

- n. Time and cost in building the business---the business was already built when acquired, therefore no additional cost for this consideration.
- o. Establishment of SOP's---For a system without treatment, most aspects are readily established. An estimate of \$40,000 is provided based on service area size.
- p. Customer lists/data/billing/financial---Aqua has its own billing system. Nonetheless, the financial information and customer histories are quite useful. Data entry is streamlined and parallel billing to insure a seamless transition is valuable. An estimate for the NMU system is \$60,000.
- q. Water allocation for Lake Michigan--- The initial allocation and the amendments thereafter with IDNR are an important right to be transferred. In western water systems the water rights are valued separately and added to the system value. That is not the case for the NMU system.

The above exercise is not exhaustive and not at the level of an appraisal. Nonetheless, a general indication of intangible potential levels of value for NMU with a 15% band provided may be in the \$2.7 million to \$3.7 million range.

6. Generally could you compare the two approaches to intangible value?

The above build up method is not complete or exhaustive. If the tangible personal property and real estate cost results at the offer amount or \$22,000,000, then the factor approach would result in an amount between \$3.3 and \$4.4 million.

Hopefully the above answered the Village team questions. Feel free to share this letter with whomever you believe could benefit from its contents.

If you have additional questions, do not hesitate to contact me.

Very truly yours, Hartman Consultants, LLC

Gerald C. Hartman PE, BCEE, ASA