SELA MATTER

Appraisal Report
Southeastern Louisiana Water & Sewer Co., LLC

Prepared for St. Tammany Parish, Louisiana
October 2006

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Section 1
PREMISE OF THE APPRAISAL

Purpose and Intended Use

R. W. Beck, Inc., was retained by St. Tammany Parish, Louisiana (the Parish) to perform an independent appraisal to determine the fair market value of the water and wastewater systems presently owned and operated in the Parish by Southeastern Louisiana Water & Sewer Co., LLC (SELA). The Parish, located on the north shore of Lake Pontchartrain, is one of the fastest growing parishes in the state. SELA is a private water and sewer company located in Mandeville, Louisiana, that provides water and wastewater service to customers throughout St. Tammany Parish and in part of Tangipahoa Parish. SELA's water assets in St. Tammany Parish include 27 well sites and 89 miles of water mains serving 7,362 water customers. SELA's wastewater assets in the Parish include 36 wastewater treatment plants serving 5,846 wastewater customers. SELA has experienced significant customer growth as the population in the Parish has grown.

SELA and the Parish have had preliminary discussions regarding the potential sale of SELA's water and wastewater assets that are located in the Parish (hereinafter referred to as the "Subject Property" or "SELA System"). The Parish retained R. W. Beck to perform an appraisal to determine the fair market value of the SELA System.

In undertaking the studies and analyses required to provide an opinion with respect to the fair market value of the Subject Property, we have relied on generally accepted valuation methods and procedures. This appraisal is a Complete Appraisal utilizing a Summary Appraisal Report format as those terms are defined in the Uniform Standards of Professional Appraisal Practice (USPAP).

Date of Valuation

The fair market value of the Subject Property was estimated as of September 1, 2006.

Definition of Fair Market Value

The definition of fair market value used in this report is set forth in USPAP as follows:

> "Market value is the most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

1. Buyer and seller are typically motivated;
2. Both parties are well informed or well advised, and acting in what they consider their best interests;
3. A reasonable time is allowed for exposure in the open market;
4. Payment is made in terms of cash in United States dollars or in terms of financial arrangements comparable thereto; and
5. The price represents the normal consideration for the property sold unaffected by special or creative financing of sales concessions granted by anyone associated with the sale."[1]

Property Interest Appraised

The property interest being valued is the ownership rights of SELA in the Subject Property with no restrictions, indebtedness, or other encumbrances. A description of the Subject Property can be found in Section 3 of this report.

Highest and Best Use

Highest and best use is defined as the reasonably probable and legal use of the property being appraised "that is physically possible, appropriately supported, and financially feasible, and that results in the highest value."[2] In our opinion, the highest and best use of the Subject Property is its current use, to provide water and wastewater utility service.

Scope of Work

This appraisal addresses the fair market value of SELA's water and wastewater systems located in the Parish.

In undertaking the studies and analyses required to provide an opinion of the fair market value of the Subject Property, we have relied on generally accepted valuation methods and procedures in accordance with USPAP. As part of the appraisal, R. W. Beck considered all three generally accepted approaches to valuation (cost, income, and market) and their degree of applicability in estimating the value of the Subject Property. The results of our analyses and the indicators of value developed are described in Section 5 of this appraisal report.

R. W. Beck performed a field review of the accessible and visible facilities comprising the Subject Property from July 31 through August 3, 2006. The purpose of the field review was to see the property, verify data on maps and inventory records provided by SELA, determine typical construction practices and assess the condition of the

[1] *Uniform Standards of Professional Appraisal Practice* (USPAP), Glossary.
[2] USPAP.

facilities. The results of the field review are summarized in Section 3 of this appraisal report.

R. W. Beck also performed a limited review of data received from a records request made of the Louisiana Department of Environmental Quality (DEQ) and the Louisiana Department of Health regarding SELA's compliance with environmental regulations, such as the Safe Drinking Water Act and Clean Water Act requirements. The results of our limited environmental review are discussed in Section 4 of this appraisal report.

Information Reviewed

In performing the appraisal, R. W. Beck reviewed data provided by SELA and the Parish. We also relied on other publicly available information and R. W. Beck's knowledge and expertise of water and wastewater systems in preparing the appraisal. Following is a list of some of the documents reviewed:

- *Company Perspective* dated April 2005 and *Company Perspective, Executive Summary* dated July 20, 2006, prepared by SELA.
- *Water and Wastewater Systems Depreciated Asset Valuation of Southeastern Louisiana Water and Sewer Co., LLC*, prepared for SELA by Professional Engineering Consultants Corporation (PEC), August 2005.
- Map showing SELA's water well and wastewater treatment facility locations.
- SELA's audited financial statements as of September 30, 2002 and 2003.
- SELA's audited financial statements for the three-month period ended December 31, 2003.
- SELA's draft audited financial statements as of December 31, 2004 and 2005. (At the time of our analyses, SELA's audit report for 2004 and 2005 had not been finalized.)
- The SELA website, www.selawater.com.
- SELA Current and Future Business Activity, document from SELA.
- *St. Tammany Parish Wastewater Consolidation Program – Phase II, Final Report*, prepared for the Parish by CDM, August 2004.
- *St. Tammany Parish, 10-Year Infrastructure Plant*, presentation and Fact Sheet.
- Louisiana Public Service Commission Order 22311 in Docket U-22311 re: SELA application for authority to revise its water and sewer rates, dated April 27, 1998.
- Louisiana Public Service Commission Order 27232(B) in Docket U-27232 re: SELA application for authority to revise its water and sewer rates, dated December 1, 2004 and Staff Report and Recommendation dated December 31, 2003 in the docket.
- Financial data provided by SELA, which has been updated monthly to reflect current operating results.

- Records provided by DEQ and the Louisiana Department of Health regarding SELA compliance with environmental regulations.
- *Blue Chip Economic Indicators*, March 30, 2006.
- *Handy-Whitman Index of Public Utility Construction Costs*, Whitman, Requardt and Associates, January 1, 2006.

R. W. Beck, Inc.

R. W. Beck, Inc., is an independent firm of engineers and consultants providing professional services in the fields of operation, planning, organization, financial analyses, engineering design, construction management and other matters related to water, wastewater, electric, gas and solid waste utilities. The firm has extensive experience in the utility industry including valuation and appraisal of utility and industrial property. R. W. Beck has offices in Austin, Texas; Boston, Massachusetts; Columbus, Nebraska; Dallas, Texas; Denver, Colorado; Indianapolis, Indiana; Minneapolis, Minnesota; Nashville, Tennessee; Orlando and Tampa, Florida; Phoenix, Arizona; Sacramento and San Diego, California; and Seattle, Washington.

Since it was founded in 1942, R. W. Beck has been involved in property valuation. The firm has provided appraisal reports for a wide range of sizes and types of utility property. With a staff having significant experience in providing services related to appraisals of utility systems and in the design, construction and operation of water and wastewater systems, R. W. Beck is well qualified to prepare appraisal reports.

Specifically, the appraisers and other personnel working on this assignment have the knowledge and experience to complete the assignment competently. A list of individuals contributing to the appraisal report and a summary of their qualifications and experience are provided in Exhibit 1 to this report.

Section 2
ASSUMPTIONS AND LIMITING CONDITIONS

In the preparation of this appraisal report and the opinions that follow, we have made certain assumptions with respect to conditions that may occur in the future. In addition, we have used and relied upon certain information and assumptions provided to us by sources which we believe to be reliable. We believe the use of such information and assumptions is reasonable for the purposes of this report. To the extent there are changes to the underlying data and assumptions, the results of the study may change. The conclusions and opinions of value found in this report are made expressly subject to the following conditions and stipulations:

1. No responsibility is assumed by R. W. Beck for matters that are legal in nature, nor do we render any opinion as to the title, land and/or land rights, which are assumed to be good and marketable.
2. Except as otherwise stated in this report, no opinion is intended to be expressed for matters that would require specialized investigation or knowledge beyond that normally used by an appraiser engaged in valuing the type of assets described in this report.
3. All existing liens and encumbrances have been disregarded and the value of the property was appraised as though free and clear and under responsible ownership.
4. R. W. Beck personnel performed a field review of the Subject Property from July 31 to August 3, 2006. Based on our observations of the accessible and visible equipment, the facilities appear to be in average condition for plant of comparable type, age and location. In performing the appraisal, we assumed that there are no other hidden or unapparent conditions that would make the Subject Property more or less valuable.
5. Inventory quantities used in the appraisal were developed by R. W. Beck based on data and maps provided by SELA, which were reviewed and verified by R. W. Beck during the field reviews. R. W. Beck developed current planning level construction cost estimates based on typical industry practices.
6. R. W. Beck did not perform analyses to determine the value of land, easements and other property rights of way. As discussed in Section 5, we relied on information provided by SELA to estimate the value of land, which is incorporated into the cost approach indicators of value.
7. For the purpose of the appraisal, we have assumed that the Subject Property conforms to all applicable zoning and use regulations and restrictions.
8. R. W. Beck has not conducted any investigations, nor have we reviewed studies performed by others, regarding environmental issues. For the purpose of this appraisal, R. W. Beck performed a limited review of records obtained from DEQ

and the Department of Health regarding SELA's compliance with environmental regulations. As described in Section 4, SELA pled guilty in December 2005 in a plea agreement to violations of the federal Clean Water Act that occurred between January 1, 1991 and October 1, 2002. In performing the appraisal, we have assumed that SELA is presently in compliance with all federal, state and local environmental and regulatory requirements and that there will be no further fines or corrective action taken against the company.

9. No one outside R. W. Beck has provided significant assistance to the preparation of this report. Individuals affiliated with R. W. Beck and contributing to this report are Nancy Heller Hughes, ASA, Senior Appraiser and Project Manager; Edward Wetzel, PhD, P.E., Client Liaison; Rodney Chapin, P.E., Senior Engineer; Paul Johnson, P.E., Staff Engineer; Priscilla Ochoa, P.E., Staff Engineer; John McNurney, Environmental/Regulatory Compliance; Arthur J. Griffith, P.E., Senior Utility Analyst, Eugenia M. (Gina) Baxter, Staff Analyst; and Michael G. Lane, ASA, Review Appraiser. A description of the qualifications and experience of the individuals contributing to the appraisal report is provided in Exhibit 1.

10. The studies and analyses undertaken in the preparation of the opinion contained herein have been performed in accordance with standard engineering practices and the Uniform Standards of Professional Appraisal Practice (USPAP) as promulgated by the Appraisal Standards Board of the Appraisal Foundation.

Section 3
DESCRIPTION OF THE PROPERTY

Subject Property

The Subject Property consists of the water and wastewater facilities owned and operated by SELA in St. Tammany Parish.[3]

SELA is a privately owned limited corporation located in Mandeville, Louisiana. The company was originally formed in 1981 under the name of Briarwood Utility Company, to provide water utility service to a housing subdivision then under development. Today, the majority of SELA's customers and facilities are located in West St. Tammany Parish, a rapidly growing part of the Parish. A list of areas served by SELA is provided in Exhibit 2.

As of August 2006, SELA served 7,362 water customers and 5,846 wastewater customers. SELA serves mostly single-family residential customers, with some multi-family residential, commercial and healthcare industry customers. Table 3-1 shows the growth in customers in recent years.

Table 3-1
Number of SELA Customers

	Water	Wastewater
December 2003	5,461	NA
December 2004	6,218	NA
December 2005	6,792	5,382
August 2006	7,362	5,846

SELA's growth comes primarily from providing water and wastewater service to new housing subdivisions under development in the Parish. A large portion of the facilities constructed in new subdivisions are paid for (i.e., contributed) by the developer. Following is a description provided by SELA about how utility service is provided to a new subdivision:

> "In providing utilities for the subdivision development in the Parish, SELA receives cash from the developer for the wastewater (treatment) plant during the infrastructure development phase of the subdivision. The developer is responsible for putting in the water and sewer infrastructure. When construction is complete and SELA has been awarded the services for the subdivision, the sewer and water assets in

[3] The Hidden Pines water/wastewater system that SELA owns in Tangipahoa Parish is not part of the assets that would be sold to the Parish and therefore, is not part of the Subject Property.

> the ground are deeded back to SELA, at no cost to the company. When subdivision connections to a wastewater plant begin to maximize the volume, larger plants replace the smaller ones. The smaller plants are then refurbished and sold to the next development to support those requirements."[4]

SELA is subject to rate regulation by the Louisiana Public Service Commission (LPSC). Under rate regulation, prices (i.e., rates) are set to recover the utility's operating expenses, including taxes, plus allow the utility to earn a fair return on rate base, as shown in the equation below:

Operating Revenues = Operating Expenses + (Rate of Return)(Rate Base)

Rate base is generally equivalent to the utility's net investment in plant, property and equipment that is used to provide service, *excluding* any amounts that were contributed by the customer (or developer). SELA's last rate increase was in 2004.[5] SELA has a request to increase rates pending before the LPSC.

SELA must also comply with state and local environmental regulations, such as the Safe Drinking Water Act and Clean Water Act requirements. A limited review of SELA's environmental compliance record is discussed in Section 4 of this appraisal report.

Description of Water Facilities

The water system owned and operated by SELA consist of water mains, water wells, well pumps, chemical feed systems, elevated reservoirs and hydropneumatic reservoirs.

An inventory of SELA's water facilities was developed after visual inspection of the water wells and storage sites during the July 31 through August 3, 2006 field review. Additional information was gathered from drawings and records of constructed facilities. The inventory is as thorough as practicable, but in the case of the water mains, the inventory is believed to be incomplete due to unavailable information for particular subdivisions within SELA's service area.

Water Mains

SELA's water mains range in size from 2-inch to 12-inch in diameter, and are made of polyvinylchloride (PVC) or high-density polyethylene (HDPE). Most of the water mains are installed in the roadway right-of-way outside of the paved area. The method of installation is by trenching with boring across paved roads. Each single-family residential customer is serviced by a one-inch service lateral and meter. Commercial and other customers are serviced similarly as demand requires.

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4 SELA *Company Perspective*, April 2005, Executive Summary, page i.

5 LPSC Order U-27232(B), December 1, 2004

The average age used for SELA's water mains is nine years as reported in the PEC Valuation Study. Table 3-2 is an inventory of the available information for each size water main in SELA's system.

Table 3-2
Pipe Inventory

Description	Quantity (linear feet)
2-inch HDPE/PE	1,230
4-inch and smaller PVC	24,314
6-inch PVC	16,379
8-inch PVC/PE	424,974
8-inch HDPE	124
12-inch PVC	3,749
Total	470,770

Water Well Sites

SELA owns and operates 27 well sites in the Parish. Most of these well sites consist of a hydropneumatic tank, well, well pump, chemical feed system if needed, and associated piping and controls within a fence enclosure. Three of the sites utilize a ground reservoir or elevated reservoir to provide storage. Table 3-3 below provides a listing of each well site and its associated appurtenances.

Table 3-3
Well Sites

Well Site	Number of Pumps	Reservoir Volume (1)	Chemical Feed / Treatment Type (2)
Bon Temps	1	20,000 gallons	None
Del Oaks	2	20,000 gallons	Cl & TMB 461
Hwy 22	2	80,000 gallons	Cl & TMB 461
Madisonville Woods	2	6,000 gallons	Cl & TMB 460
Faubourg Coquille	2	45,000 gallons	Cl & TMB 432
Black River	2	20,000 gallons	None
Indian Trace	1	20,000 gallons	Cl & TMB 461
Fox Branch	1	45,000 gallons	Sand Filter
Savannah Trace	1	30,000 gallons	Cl & TMB 461
Northridge	1	10,000 gallons	Cl & Sand Filter
Lake Hills	1	8,000 gallons	Cl & Sand Filter
St. Gertrude	1	3,000 gallons	Cl
Terra Mariae	2	30,000 gallons	Cl, TMB 461 & 908, Sand Filter
Abita Lakes	2	45,000 gallons	Cl & Sand Filter
River Oaks	1	(2) – 10,000 gallons	Cl

Well Site	Number of Pumps	Reservoir Volume (1)	Chemical Feed / Treatment Type (2)
St. Joe	1	10,000 gallons	Cl
Medcath	2	43,000 & 20,000 gallons	Cl
Soult Street	2	45,000 & 125,000 gallon ground storage	Cl
Hwy 1088	1	20,000 gallons	Cl
Ozone	2	45,000 gallons	Cl
Helenberg	2	53,800 gallons	Cl
Lazy Creek	1	30,000 gallons	Cl & TMB 461
Koop Drive	2	250,000 gallon elevated	Cl
Timber Branch	2	30,000 gallons	Cl
Cristwood	1	20,000 gallons	Cl
Timberlane	2	40,000 gallons	Cl

(1) Hydropneumatic tank unless otherwise noted.
(2) Cl = Chlorine, TMB = trimethylbenzene, Sand Filter = Greensand iron filtration.

Condition of Water Facilities

SELA's water facilities range in age from one to 25 years. As evidenced by the field inspections conducted with SELA personnel, each well site is visited at least three times a week. Chlorine residual readings are taken and the well site is visually inspected for any maintenance issues that need to be addressed.

The condition of the water facilities appears to be consistent with its age. Continuing the maintenance practices that SELA currently has in place should allow a majority of the facilities to reach their predicted asset life. Table 3-4 shows the estimated average service lives used in evaluating the depreciated cost of each water system component.

Table 3-4
Average Service Lives – Water Facilities

Asset	Average Service Life
PVC Pipe	45 years
HDPE Pipe	45 years
Water Meters	20 years
Service Laterals	40 years
Fire Hydrants	45 years
Water Wells	30 years
Well Pump	20 years
Ground Reservoir	25 years
Elevated Reservoir	37 years
Hydropneumatic Tank	35 years
Chemical Feed System	8 years
Electrical Controls	15 years

Potential Future Costs for Water System

The SELA system relies primarily on pumps to provide capacity. However, in a power outage, the pumps would not be able to run without back-up generation. SELA has one 250,000-gallon elevated reservoir at the Koop Drive well site. In addition, the Parish owns the 300,000-gallon elevated reservoir at the Diversified site, which provides some benefit to the SELA System.[6] The Parish indicated that adequate water storage capacity to meet fire flow demands is a problem throughout the Parish. We have not factored the cost of building additional storage into the appraisal analyses. However, as the SELA System grows, storage represents a potential future cost that could be significant.

Description of Wastewater Facilities

The wastewater collection system consists of approximately 64 miles of gravity sewer mains, 129 lift stations and 25 miles of force mains. SELA currently operates 43 wastewater treatment plants. The wastewater system inventory was developed based on information provided by SELA in addition to site visits and a review of record drawings. The 2005 PEC Valuation Report was also reviewed. The system inventory is presented as Table 3-5.

[6] The Diversified well and elevated storage tank are owned by St. Tammany Parish and are not included in the Subject Property valued in this appraisal. SELA contributed to the cost of the Diversified storage tank and has the right to excess capacity beyond 160,000 gallons/day.

Section 3

Table 3-5
Wastewater Inventory

Wastewater Component	Quantity
4" and 6" Gravity Sewer Main (PVC)	7,340 L.F.
8" Gravity Sewer Main (PVC)	328,670 L.F.
Concrete Manholes	1,300 EA
Lift Stations	129 EA
Less than 2.5" Force Main (PVC)	6,622 L.F.
3" and 4" Force Main (PVC)	50,545 L.F.
6" Force Main (PVC)	30,333 L.F.
8" Force Main (PVC)	23,602 L.F.
10" Force Main (PVC)	525 L.F.
12" Force Main (PVC)	22,000 L.F.
Package Wastewater Treatment Plants (Less than 100,000 gallons per day)	34 EA
Regional Wastewater Treatment Plants (Greater than 100,000 gallons per day)	5 EA

Inventory data for the wastewater collection system were obtained from maps provided by SELA for each development within the service area. Gravity collection sewers within the system range in size from 4 to 8 inches, and are made of PVC pipe. Manholes are located at various intervals along the sewer alignments and at each change in direction. There are approximately 1,300 manholes within the system. The gravity sewers collect and convey wastewater to sewage lift stations, which then pump wastewater through force mains to the designated treatment plant.

A majority of the lift stations within the system are below-ground concrete wells, approximately 4 to 8 feet in diameter. The pumps are submersible and discharge piping within the well is flexible. Pump controls are mounted above ground on a wooden panel, along with an audible and visual alarm in case of pump failure or high water level within the well.

The force mains within SELA's system vary from smaller than 2.5 inches to 12 inches, and are also PVC pipe.

The system currently consists of 43 wastewater treatment plants, ranging in size from 6,000 gallons per day (gpd) to 1,000,000 gpd. Treatments plants recently taken offline include Del Oaks, Black River, Quail Creek, Helenberg, Forest Brook and Timber Lane. It is our understanding that the West St. Tammany plant is currently under construction and will eventually replace the Christwood, Highway 21, Madison Farms and Seymour Myers plants. Consequently, those plants were not included in the inventory for the purpose of this valuation. For this appraisal report, we identified 34 small package treatment plants (capacity less than 100,000 gpd) and 5 larger field-fabricated treatment plants. We visited each of the wastewater treatment plants from July 31 through August 2, 2006 with SELA staff.

All of the treatment plants are equipped with small bar screens to remove large solids; aeration basins and clarifiers for reduction of biochemical oxygen demand and suspended solids; and chlorine contact chambers to disinfect the wastewater prior to discharge. One plant uses chlorine gas disinfection; the others use sodium hypochlorite. A small number of plants are equipped with equalization tanks to control peak flows and sand filters to remove suspended solids. A majority of the treatment plants are above ground steel plants of various sizes and designs. Many of the treatment plants were fabricated or refurbished by SELA staff.[7] Excess solids are periodically pumped from each of the treatment plants using a vacuum truck and transported to the solids handling facilities located at the Westwood site. This site is equipped with an aerobic digester and belt press to stabilize and dewater the solid material.

Each treatment plant is permitted and regulated by DEQ. SELA is required to submit a monthly Discharge Monitoring Report (DMR) for each treatment facility presenting flow and water quality laboratory data.

Condition of Wastewater Facilities

A limited assessment of the condition of existing wastewater facilities was completed by our site visits. This assessment focused on easily accessible facilities such as treatment plants and lift stations. Data in the PEC valuation report regarding the age of the treatment plants were confirmed during the site visits. The condition of the wastewater treatment facilities owned by SELA appeared to be in line with the [reported condition and relative] ages identified in the 2005 PEC valuation.

Since no other data was available regarding the age of gravity mains and manholes, force mains and lift stations, we estimated the average system age based on: 1) historic customer numbers, and 2) treatment plant ages. The average system age using both methods was calculated to be approximately 6 years. (The PEC valuation report also used a 6-year average age for the wastewater collection system.)

Based on the results of the field assessment and accepted industry standards for similar wastewater systems, Table 3-6 summarizes the estimated average service life for each facility component.

Table 3-6
Average Service Lives – Wastewater Facilities

Wastewater Component	Average Service Life
Gravity Sewer Mains (PVC)	45 years
Concrete Manholes	30 years
Lift Station Wet Well (Concrete)	32 years
Lift Station Pumps and Controls	18 years
Force Main (PVC)	30 years
Wastewater Treatment Plants (Steel)	10 years
Wastewater Treatment Plants (Concrete)	32 years

[7] SELA stated that it will retain ownership of the fabrication department.

A 10-year average service life was used to depreciate the steel package treatment plants. Under the Parish's Wastewater Consolidation Program, the Parish will construct large regional wastewater treatment plants to serve the East Tchefuncte, West Tchefuncte and East Slidell Wastewater Management Areas (WWMAs), which include the areas where SELA primarily provides service. Construction of the large regional wastewater treatment plants will "allow the existing wastewater treatment plants located within each of these three WWMAs to be decommissioned as soon as practical and financially feasible."[8] Use of a 10-year average service life for this property is appropriate. A 10-year average service life is also consistent with the average age of wastewater treatment plants that SELA has recently retired or is about to retire from service.

Potential Future Costs for Wastewater System

During the field review, SELA staff identified significant inflow and infiltration (I/I) problems throughout the entire collection system that cause excessive wastewater flows at the treatment plants during storm events.[9] Most of SELA's treatment plants are not equipped with tanks to control these flows. In some cases, wastewater flows during storm events exceed treatment plant capacities.

Excessive I/I increases the risk of sewer overflows and increases the cost of conveying and treating wastewater. I/I problems will remain a concern under the Parish Wastewater Consolidation Program because of the costs to convey and treat storm water or groundwater that gets into the wastewater system. In addition, having to treat I/I requires additional capacity at the regional treatment plants, which translates into higher costs.

We have included capital expenditures of $400,000 per year (in 2007 dollars), which is typical for a system of SELA's size, in the discounted cash flow analyses described in Section 4 to address I/I problems in the System.

[8] CDM Report, St. Tammany Parish Wastewater Consolidation Program – Phase II, Final Report, August 2004, Summary of Recommendations, page ES-2.

[9] I/I is clean storm water and/or groundwater that enters the system through cracked pipes, leaky manholes or improperly connected storm drains and down spouts. In addition, a significant source of I/I for SELA is through its lift stations.

Section 4
ENVIRONMENTAL

Historically SELA's record of environmental compliance has not been good. However, it appears that the company has made improvements in this area since 2003. Costs associated with environmental compliance include the operating costs of the compliance program, civil penalties and defense efforts as well as system improvements to maintain compliance.

Violation of Federal Clean Water Act

In December 2005, SELA pled guilty to a felony violation of the Federal Clean Water Act and agreed to pay a $2.1 million fine for improperly operating sewer systems throughout southwestern St. Tammany Parish and polluting local waterways over an 11-year period. On March 29, 2006, SELA was sentenced in Federal District Court pursuant to the plea agreement to five years probation and fined $2.1 million for violating the Federal Clean Water Act. The fine was reported to be "the largest single corporate environmental criminal fine ever in Louisiana".

The Louisiana Department of Environmental Quality (DEQ) and the United States Environmental Protection Agency (USEPA) alleged that during an 11-year period from January 1, 1991 to October 1, 2002, SELA repeatedly violated discharge limits of federal and state permits at more than two dozen wastewater treatment plants throughout southwestern St. Tammany Parish. Investigators charged that in some instances, SELA operated sewer plants without permits, failed to report violations to DEQ and falsified reports to the state. SELA also overloaded some plants by continuing to add more homes to systems that did not have the capacity to handle the extra sewage.

The plea agreement acknowledged that SELA had spent approximately $12 million since the investigation began to correct the violations charged by the Government. There has also been a change in SELA management since 2003 with Mr. Jared Riecke taking over as chief executive officer and Mr. Bruce Cucchiara joining SELA as president. In addition, SELA hired Ms. Heather Salyer to serve as the company's environmental compliance officer.

Bruce Cucchiara, president of SELA, has stated that SELA will pay all remaining amounts owed to the federal government in connection with the EPA fine when the System is sold. Our appraisal of the System assumes that SELA will be responsible for paying all remaining amounts in connection with the USEPA fine. However, there could be additional fines or corrective measures in the future. In a press release issued March 29, 2006 at the time of SELA's sentencing, the United States Attorney's Office stated "Now that the criminal case is concluded, our civil enforcement side will review

SELA's activities and corrective measures and determine whether additional potential fines or actions are necessary to protect our environment."[10]

We strongly recommend that the Parish conduct additional due diligence beyond the limited review performed in connection with this appraisal to identify potential areas of risk and liabilities to the Parish if it buys the System.

Review of Environmental Compliance Records

R. W. Beck reviewed selected records from key regulatory agencies. That review was based on a data request of DEQ and the Louisiana Department of Health to obtain documents regarding SELA's compliance with environmental regulations. We received a total of 437 documents from DEQ on a CD and a summary spreadsheet from the Department of Health. Due to the large number of documents at DEQ, we limited our request to only those documents and correspondence related to SELA's permits and compliance issues.

Following are several observations based on a limited review of the DEQ documents:

1. There are numerous consent orders at several SELA wastewater treatment plants for typical infractions such as discharge limit excursions and associated missing noncompliance reports, sampling errors, overflows, record keeping errors, improper operations and maintenance procedures and monitoring and testing omissions. It was not clear from the documents what civil penalties were imposed or the current disposition of those penalties.
2. There appears to be a real improvement in the compliance record of SELA since 2003. This change seems to correspond to the revamping of SELA's compliance program and the hiring of Ms. Heather Salyer. Continuation of that program has likely reduced compliance risks and associated costs during the past three years compared to previous years.
3. There were compliance issues at some of the plants related to sludge handling and disposal, most notably Westwood and Quail Creek. All sludge from SELA treatment plants is processed at Westwood and disposed of at a nearby landfill; although some land application has been done on occasion. The actual compliance concerns were addressed in each case.
4. In a related issue, SELA is apparently in the process of closing an oxidation pond at the Quail Creek wastewater treatment plant. SELA has requested direction from DEQ regarding requirements for closing the oxidation pond but, to the best of our knowledge, has not yet received a response from DEQ. It is unclear what the closure requirements from DEQ will be, and those requirements could represent a significant cost.
5. A relatively recent compliance order was issued to SELA on March 1, 2006 involving the Preferred Equities wastewater treatment plant. Because of the recent issue, no resolution of the concerns (failure to include a wastewater source

[10] Press release, March 29, 2006, United States Attorney's Office, Eastern District of Louisiana, "SELA Sentenced."

to the plant and a violation of the National Pollutant Discharge Elimination System (NPDES) permit) was indicated in the correspondence. If design modifications are involved, the costs could be substantial. A copy of the referenced compliance order dated March 1, 2006 is also provided in Exhibit 3.

After reviewing the data regarding water system violations from the Louisiana Department of Health, we suggest that further investigation of the Briarwood water treatment plant may be in order. Of the 62 action items listed by the Department of Health, 28 were related to Briarwood and 11 of those occurred during the last 12 months (since October 2005). The nature of the violations was not egregious, so the impacts may not be substantial. However, if design modifications are warranted, the costs could be significant. The other action items on the Department of Health's list of violations were spread among several plants with nearly half (29) of the action items occurring prior to 2002. A copy of the spreadsheet from the Department of Health titled *SELA Water Violation Enforcement History* is included at the end of Exhibit 3.

2002 Consent Decree and TMDLs

In April 2002, a consent decree was approved in U.S. District Court for the Eastern District of Louisiana to settle a claim brought by the Sierra Club and the Louisiana Environmental Action Network under the Clean Water Act against DEQ and USEPA. The Clean Water Act requires DEQ and USEPA to (1) identify waters for which applicable technology-based and other required controls are not stringent enough to implement water quality standards, (2) establish a priority ranking for such waters, and (3) establish Total Maximum Daily Loads (TMDLs) for pollutants for those waters that are not in attainment with water quality standards. The plaintiffs alleged that the USEPA had failed to adequately identify water quality limited segments still requiring TMDLs in Louisiana and failed to adequately establish TMDLs in Louisiana.

Based on our review of the technical issues addressed in the consent decree, it does not appear that DEQ and USEPA are required to institute new TMDLs; they only have to evaluate the need for them and if necessary, establish appropriate TMDL limits. Attachment A to the consent decree at pages 11 and 12 identifies rivers in the Parish that require consideration and Attachment B sets the schedule for evaluating TMDLs. The receiving waters for SELA wastewater treatment plants in St. Tammany Parish, which are tributaries to Lake Pontchartrain, are not scheduled for consideration until 2007, with a decision on TMDLs due in 2011 or 20012. It is difficult to predict the types of changes we may see in TMDLs or even if new TMDL limits will be forthcoming in five or six years. Therefore, it is difficult to predict the potential impact on the various small wastewater treatment systems under consideration in this appraisal.

One TMDL that the Parish should be aware of is mercury and the DEQ's mercury initiative. Mercury levels have been measured in fish tissue from several Louisiana river systems at levels that may be of concern depending on the amount of fish consumed by individuals, especially pregnant women and children. DEQ's mercury initiative is currently focused on measurement of ambient levels and raising public

awareness. However, mercury TMDLs could be used to limit even minor contributors to mercury levels in water bodies like sewage treatment plants.

As small wastewater treatment plants are combined into larger regional plants, the mercury initiative could become a factor for SELA. Current DEQ requirements apply to treatment plants with effluent at or greater than 1 mgd. The minimum requirement under DEQ's mercury initiative is for these treatment plants to sample and analyze mercury in the effluent down to something like 0.000015 mg/l. Currently, most commercial laboratories can only reach detection limits of 0.0002 mg/l. Special "clean sampling techniques" will be required and there are only a few laboratories in the country that can run the analysis. If any mercury is detected using the new method, the treatment plant will be required to implement a mercury minimization program. All of these factors represent potential costs.

Future Compliance Issues

A detailed analysis of environmental issues involving SELA is beyond the scope of this appraisal. R. W. Beck has not conducted any investigations regarding environmental issues at SELA other than the limited review of selected documents from DEQ and the Department of Health described above. Before the Parish purchases the SELA System, we recommend that the Parish have a detailed environmental investigation performed to identify potential future liabilities. Once the Parish takes ownership of the System, it will own the environmental problems and the regulators will no longer hold SELA accountable. Therefore, we also recommend that an escrow fund be created from the proceeds of the sale to cover any future potential non-compliance costs that may arise resulting from violations that occurred under existing SELA ownership.

Section 5
ANALYSES

Fair Market Value Analyses

There are three generally accepted approaches to estimating the value of property:

- Cost approach – the value of the property is based on the premise that an informed buyer would pay no more than the cost of producing a substitute property with the same utility as the subject property.
- Income approach – the value of the property is estimated by capitalizing or determining the present worth of the prospective net income from the property.
- Market approach – assesses value based on recent fair market sales of similar facilities under similar circumstances.

R. W. Beck considered all three approaches to valuation, but relied on the cost and income indicators of value to determine the fair market value of the property. The market approach was not relied upon due to the lack of utility sales transactions that are comparable to the Subject Property.

Cost Approach

OCLD and RCNLD Indicators of Value

Two indicators of value that are commonly considered under the cost approach when valuing regulated utility property are the Original Cost Less Depreciation (OCLD) value and the Reproduction Cost New Less Depreciation (RCNLD) value. OCLD is defined as the original cost of the property when it was first put into service as a public utility, less depreciation. The OCLD value is an estimate of the net book value of the property. RCNLD is defined as the cost of constructing an exact replica of the property at current prices with the same or closely related materials, less depreciation. The RCNLD and OCLD values tend to set the upper and lower limits, respectively, on the range of fair market value for regulated utility property.

Exhibit 4 shows the calculation of the estimated RCNLD and OCLD values for the SELA System.

R. W. Beck estimated the current construction cost, or Reproduction Cost New (RCN) value of the System, based on the inventory quantities described in Section 3. Average unit costs were estimated based on local contractor quotes, accepted cost estimating indices, and engineering industry experience. All costs are in 2006 dollars and include labor, materials and equipment. Overhead percentages were added to the

direct construction costs to account for general administration and engineering/ construction management.

Depreciation was calculated using the straight-line method of depreciation based on the facility age and estimated average service lives for the facilities. The estimated average service livess for the water and wastewater facilities are described in Section 3 (see Tables 3-4 and 3-6). The RCNLD was then calculated for each system component.

The OCLD value was estimated by trending the current cost figures to the year of installation using the *Handy-Whitman Index of Public Utility Construction Costs*, a semi-annual publication widely used in the utility industry.

Table 5-1 shows the RCNLD and OCLD values developed for the water and wastewater systems.

For other plant assets, such as vehicles and office furniture and equipment, we assumed that the RCN and RCNLD values were equal to the investment shown on SELA's books. Most of these assets are relatively short-lived, so it was assumed that the replacement cost was equal to the original cost investment.

The current market value of land shown in Table 5-1 is based on data provided by SELA or found in the PEC Valuation Report prepared for SELA. The original cost value of land is equal to the amount of investment in land shown on SELA's books.

Table 5-1
Estimated RCNLD and OCLD Values
as of September 1, 2006

	RCN	RCNLD	OC	OCLD
Water System [1]				
Well Sites				
Wells	$6,043,923	$4,031,563	$4,551,505	$3,125,753
Pumps	2,334,737	1,321,109	1,776,753	1,059,668
Reservoirs	2,996,175	1,954,648	1,832,226	1,434,475
Distribution System				
Water Mains	10,151,713	8,121,370	6,698,037	5,358,430
Water Meters	989,000	791,200	825,496	660,397
Service Laterals	4,163,069	2,300,688	2,759,963	1,517,980
Hydrants	2,142,000	1,713,600	1,572,431	1,257,945
Total Water System	$28,840,617	$20,234,178	$20,016,411	$14,414,648
Wastewater System [1]				
Treatment Plants	22,277,750	13,190,100	19,547,454	12,397,291
Collection System				
Forcemains	2,651,260	2,121,008	1,831,282	1,465,025
Gravity Pipe	14,886,564	12,641,689	10,282,472	8,731,889
Lift Stations	4,996,482	3,877,237	4,434,680	3,441,282
Total Wastewater System	$44,812,056	$31,830,034	$36,095,888	$26,035,487
Other Assets [2]				
Vehicles	$1,167,271	$730,775	$1,167,271	$730,775
Office Furniture & Equipment	57,851	20,513	57,851	20,513
Computer Equipment	132,628	100,331	132,628	100,331
Tools & Field Equipment	29,396	14,709	29,396	14,709
Total Other Assets	$1,387,145	$866,328	$1,387,145	$866,328
Land [3]				
Land	$1,727,700	$1,727,700	$517,564	$517,564
Total System	$76,767,518	$54,658,240	$58,017,008	$41,834,027
Less Contributed Plant [4]		23,503,043		17,988,632
Total Value of SELA System		$31,155,197		$23,845,395
Rounded		**$31,155,200**		**$23,845,400**

(1) R. W. Beck RCNLD/OCLD analysis (Exhibit 4).
(2) SELA Depreciation Expense Report as of December 31, 2005. Assumed that replacement cost of Other Assets, which are relatively short lived, is equal to original cost.
(3) Replacement (current) cost of land at well sites per PEC Valuation Report; current cost of land as wastewater sites per SELA (B. Cucchiara). Original cost investment in land per SELA 2005 financial statement.
(4) Based on SELA financial statements as of December 31, 2005, contributions in aid of construction are equal to approximately 43 percent of total depreciated net plant.

Depreciation

USPAP defines depreciation as "a loss in property value from any cause."[11] There are three basic types of depreciation:

- Physical deterioration – the loss in value resulting from the wear and tear of an asset in operation and exposure to various elements.
- Functional obsolescence – the loss in value caused by inefficiencies or inadequacies of the property itself, when compared to a more efficient or less costly replacement property that new technology has developed.
- Economic obsolescence – the loss in value caused by factors external to the property.[12]

The deduction for depreciation made to the values shown in Table 5-1 reflects the physical deterioration based on the observed age, physical condition and expected life of the facilities.

Functional obsolescence is reflected in the shorter average service life (10 years) used to depreciate the steel wastewater treatment plants. Under the Parish's Wastewater Consolidation Program, the Parish will construct large regional wastewater treatment plants to serve the East Tchefuncte, West Tchefuncte and East Slidell Wastewater Management Areas (WWMAs), which include the areas where SELA primarily provides service. The Parish Wastewater Consolidation Program will "allow the existing wastewater treatment plants located within each of these three WWMAs to be decommissioned as soon as practical and financially feasible."[13]

Utility rate regulation, which restricts the earnings of the utility to an allowed rate of return times an original cost rate base, is a form of economic obsolescence. Thus, the amount of economic obsolescence would be equal to the difference between the utility's RCNLD value and its OCLD rate base value. We have not made this adjustment to the RCNLD value shown in Table 5-1, preferring to show both the RCNLD and OCLD values separately. However, the effect of rate regulation on value and the relationship between the cost and income approaches to valuation for regulated utility property is discussed later in this report.

Contributed Plant

A significant portion of SELA's infrastructure is contributed plant that has been paid for by developers (i.e., customers). The RCNLD and OCLD values were adjusted to deduct the estimated value of contributed plant. Under utility rate regulation, the value of contributed plant is excluded from the calculation of rate base. In other words, the value of the System on which SELA can earn its authorized rate of return excludes the value of contributed plant. Any private buyer of the System would be

[11] USPAP, Glossary.

[12] American Society of Appraisers, *Appraising Machinery and Equipment*, 2000, pages 86, 97 and 104.

[13] CDM Report, St. Tammany Parish Wastewater Consolidation Program – Phase II, Final Report, August 2004, Summary of Recommendations, page ES-2.

subject to LPSC rate regulation and would only be allowed to earn its authorized rate of return on the same OCLD rate base as SELA, which excludes the value of contributed plant. Similarly, a government entity interested in buying the System would be reluctant to pay for contributed plant that its citizens/customers already paid for (since the developer's cost for utility infrastructure would be built into the price of the new homes). Lastly, as discussed below, SELA's accounting policy is to report the value of property and equipment net of contributed plant on its balance sheet.

The percentage of contributed plant (43 percent) applied to the RCNLD and OCLD values was estimated based on data reported in SELA's financial statements as of December 31, 2005. This calculation is shown at the bottom of Table 5-1.

Net Book Value

The net book value of property and equipment on SELA's books at December 31, 2005 is equal to $12,087,470. This amount is net of accumulated depreciation and contributions in aid of construction.

Table 5-2 shows a breakdown of SELA's property and equipment. A significant portion of the SELA system has been paid for by developers (i.e., customers) in the form of contributions in aid of construction.

Table 5-2
Net Book Value of Property and Equipment
as of December 31, 2005

Total property and equipment	$25,987,542
Less accumulated depreciation	(4,867,915)
Less contributions in aid of construction	(9,032,157)
Net book value	$12,087,470

Source: SELA draft audited financial statements for December 31, 2005 and 2004, Note 2 – Property and Equipment.

The following excerpt from the notes to SELA's financial statements explains the accounting treatment for contributions in aid of construction:

> "The Company occasionally receives contributions of water and sewer equipment in conjunction with providing services to given area. The equipment received is recorded at fair market value with a corresponding credit that effectively nets the equipment off the financial statements (See Note 2). U.S. generally accepted accounting principles require that these contributions should be recorded at fair market value with the relating gain included as income in the year received. The Company's treatment of this is consistent with tax law and the Louisiana Public Service Commission which mandates that the contribution be excluded in determining the rate base."[14]

[14] SELA draft financial statements for December 31, 2005 and 2004, Note 1 – Nature of Business and Significant Accounting Policies, Property and Equipment, page 12.

Comparison of Cost Approach Indicators of Value

Table 5-3 is a comparison of R. W. Beck's cost approach indicators of value with data reported in SELA's financial statements and the PEC Valuation Study performed for SELA.

Table 5-3
Comparison of Cost Approach Indicators of Value

	SELA Financial Statements 12/31/05	PEC Valuation Study 2005	R. W. Beck Appraisal 2006
RCNLD	NA	$56,056,619	$54,658,200
RCNLD less contributed plant	NA	Not estimated	$31,155,200
OCLD including contributed plant	$21,119,627	Not estimated	$41,834,000
OCLD less contributed plant	$12,087,470	Not estimated	$23,845,400

The trended OCLD value developed in this appraisal is an independent estimate of the net book value of the System based on a current inventory of facilities, estimated construction costs, and the age and average average service lives of the facilities. The RCNLD results shown above are similar to the valuation done by PEC in 2005. R. W. Beck's unit costs were higher than PEC's unit costs, but our average service livess were shorter. PEC did not estimate the value of contributed plant, nor did it estimate the OCLD value of the System.

R. W. Beck's OCLD indicator of value is substantially higher than the net book value of property and equipment reported on SELA's financial statements. We do not have a full explanation for the difference. Some of the difference may be due to System growth since December 31, 2005. Some of the difference may be due to the incidence of contributed plant, e.g., the investment may not have been recorded as property and equipment if the plant was paid for by the developer. In addition, the use of refurbished wastewater treatment plants could account for some of the difference in the OCLD values. SELA may be booking only the cost to refurbish the package treatment plants, which would be less than purchasing a new plant. (The unit costs used in our RCNLD/OCLD analyses are based on the cost of new package treatment plants). Also, the cost of SELA's fabrication department may be recorded as an expense (salaries) instead of capitalized as plant investment. We conclude that our estimate is a conservative estimate of the OCLD indicator of value.

Income Approach

The income approach estimates the value of property by capitalizing or determining the present worth of anticipated economic benefits from the property as a going concern. Both the direct capitalization of income and discounted cash flow (DCF) methods were used to estimate the value of the distribution systems under the Income Approach.

Direct Capitalization of Income

Under the direct capitalization of earnings method, the income value of the property is estimated by capitalizing (i.e., dividing) the net income associated with the property for a one-year period by an appropriate capitalization rate. This is shown in Equation (1) below:

(1) Value = (Revenues – Expenses) / Capitalization Rate

In theory, the income value for a regulated utility should equal its rate base value, since this is the value of the utility's investment on which it is allowed to earn its authorized rate of return. Rate base is generally equal to the original cost of plant in service less accumulated depreciation, less the cost of contributed plant.

Rates are designed to recover the utility's operating expenses plus a return on rate base, as shown in Equation (2) below:

(2) Operating Revenues = Operating Expenses + (Rate of Return)(Rate Base)

Equation (2) can be rewritten as follows:

(3) Rate Base = (Operating Revenues – Operating Expenses) / Rate of Return

By comparing Equations (1) and (3), one can see that the capitalized income value for regulated utility property is generally equivalent to its rate base value.

Table 5-4 shows the development of the capitalized income value for the Subject Property. Operating revenues and expenses (including depreciation and taxes) and the resulting net operating income are from SELA's December 31, 2005 financial statements. The capitalization rate is equal to SELA's authorized rate of return determined by the LPSC in SELA's last rate case.

As shown in Table 5-4 below, the direct capitalized income indicator of value for the SELA System is equal to $17,188,500.

Table 5-4
Direct Capitalization of Income Value

Operating Revenues	$6,282,245
Operating Expenses	$4,687,154
Net Operating Income	$1,595,091
÷ Capitalization Rate [1]	9.28%
Estimated Income Value	$17,188,481
Rounded	**$17,188,500**

(1) SELA authorized after-tax weighted average cost of capital, LPSC Staff Report in Docket 27232, December 1).

As discussed above, in theory, the income value for a rate regulated utility should equal its rate base or OCLD value, since this is the value of the utility's investment on which it is allowed to earn its authorized rate of return. Table 5-5 shows the

calculation of SELA's rate base as of December 31, 2005 using the same methodology as the LPSC Staff in SELA's last rate case.

Table 5-5
Value of SELA Rate Base

Plant in Service	$25,987,542
Less: Accumulated Depreciation	(4,867,915)
Net Plant in Service	21,119,627
Plant Under Construction	0
Total Plant	$21,119,627
Additions:	
Materials and Supplies (Inventory)	226,149
Prepayments	189,197
Working Capital (1/8 of O&M)	465,900
Total Additions to Rate Base	$881,246
Deductions:	
Customer Deposits	807,135
Customer Advances	0
Contributions in Aid of Construction	9,032,157
Deferred Income Taxes	0
Total Deductions from Rate Base	$9,839,292
Net Rate Base	$12,161,581
Rounded	$12,161,600

Based on the results shown in Tables 5-4 and 5-5, SELA earnings were above its authorized rate of return for the year ended December 31, 2005.[15] This is not to say that there should be a rate decrease; in fact, SELA presently has a rate request before the LPSC that would result in a 2.6 percent increase in water revenues and a 22.05 percent increase in wastewater revenues. The LPSC has not yet ruled on SELA's proposed rate increase.

Discounted Cash Flow Method

Under the DCF method, the direct economic benefits derived from continued ownership of the system are expressed in terms of free cash flow, which represents the total cash flow generated by the going concern that is available to the providers of both debt and equity capital.

[15] Based on SELA's 2005 financial statements, the utility earned a 13.12 percent return on rate base in 2005. (Net operating income of $1,595,091 ÷ divided by rate base of $12,161,600 = 13.12 percent).

The DCF model used to estimate the value of the distribution systems is essentially an after-tax cash flow model of annual revenues and expenses over the 2007-2016 time period. The calculation of free cash flow is illustrated as follows:

Annual Operating Revenues	
Less:	*Annual Operating Expenses*
Equals:	*Pre-tax Net Operating Income*
Less:	*Income Taxes*
Equals:	*Earnings Before Interest, Depreciation & Amortization (EBIDA)*
Less:	*Future Capital Expenditures*
	Net Changes in Working Capital
Equals:	*Free Cash Flow*

Table 5-6 shows the calculation of the income value for the SELA System using the DCF method.

Table 5-6
Discounted Cash Flow Indicator of Value
($000)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Revenues	$8,972	$9,733	$10,527	$11,355	$11,805	$12,191	$12,507	$12,747	$13,327	$13,929
Operating and Maintenance Expenses	4,828	5,242	5,670	6,113	6,547	6,950	7,320	7,656	7,981	8,319
Other Expenses (Debt Free)	1,817	1,989	2,168	2,355	2,402	2,431	2,440	2,428	2,544	2,665
Net Operating Income (Debt Free)	$2,327	$2,503	$2,689	$2,887	$2,856	$2,810	$2,746	$2,662	$2,801	$2,946
Addback Depreciation Expense	$731	$790	$850	$911	$974	$1,027	$1,072	$1,108	$1,133	$1,160
Capital Expenditures	3,423	3,506	3,590	3,678	3,289	2,883	2,454	2,003	2,050	2,100
Changes in Working Capital	64	68	70	73	71	66	61	55	54	56
Net Cash Flow	($430)	($281)	($121)	$49	$469	$888	$1,303	$1,712	$1,831	$1,950

Discount Rate	9.28%
Future Growth Rate	2.40%
Capitalization Rate for Terminal Value	6.88%
Net Present Value of FY 2006 - 2015 Cash Flow	3,303
Terminal Value	29,023
Net Present Value of Terminal Value	13,058
Enterprise Value as of August 2006	16,361
Less Working Capital	794
Value of Tangible and Intangible Assets	$15,567

Under the DCF method, the income indicator of value is equal to the sum of the present value of the projected cash flows plus the present value of the projected terminal value. The series of annual cash flows from 2007 to 2016 was discounted using a 9.28 percent discount rate, which is equal to SELA's weighted average cost of capital. For the terminal (or residual) value, the projected cash flow in year 2016 was capitalized into perpetuity at the discount rate less a growth rate equal to 2.4 percent, the projected rate of inflation, and then discounted back to 2007.

As shown in Table 5-6 above, the income value of the SELA System using the discounted cash flow method is equal to $15,567,000.

A description of the key assumptions used in the DCF model and a copy of the supporting analyses are provided in Exhibit 5.

Section 5

The DCF analysis shown in Table 5-6 assumes that rates will increase each year at the general rate of inflation. The projected annual growth in new connections assumes an increase of 700 new water and wastewater connections each year from 2007 to 2010, which is consistent with the growth in connections experienced during the 2004-2006 time periods. Beginning in 2011, we assumed that the number of new connections would decrease and then remain steady at 300 new water and wastewater connections each year from 2014 through 2016.

Expenses were projected based on the general rate of inflation, customer growth and/or change in plant investment. Annual capital expenditures were projected based on the estimated average water and wastewater capital investment per new customer multiplied by the number of projected new connections. In addition, we included capital expenditures of $400,000 per year (in 2007 dollars) to address inflow and infiltration (I/I) problems in the System. (See discussion of I/I in Section 3).

As indicated above, the income value developed in Table 5-6 assumes that SELA's rates will increase each year at the assumed rate of inflation (2.4 percent per year). However, SELA filed a proposal with the LPSC on August 9, 2005 that would restructure rates and increase water revenues by 2.6 percent and increase wastewater revenues by 22.05 percent. SELA's rate request is still pending before the LPSC.

To determine the effect of the proposed rate increase, we performed a scenario of the DCF analysis assuming that the rate increase goes into effect in 2007, with rates in thereafter increasing annually at the rate of inflation. All other assumptions in the DCF model remained the same.

Table 5-7 shows the DCF analysis assuming the SELA proposed rate increase occurs in 2007. As expected, if revenues increase and costs remain essentially the same, the income value of the System is higher. The income value of the System assuming SELA's proposed rate increase is approved is equal to $23,375,000.

Table 5-7
Discounted Cash Flow Indicator of Value
Assuming SELA Proposed Rate Increase in 2007
($000)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Revenues	$9,518	$10,350	$11,218	$12,123	$12,645	$13,096	$13,470	$13,762	$14,396	$15,054
Operating and Maintenance Expenses	4,828	5,242	5,670	6,113	6,547	6,950	7,320	7,656	7,981	8,319
Other Expenses (Debt Free)	2,026	2,225	2,432	2,648	2,724	2,777	2,809	2,817	2,953	3,095
Net Operating Income (Debt Free)	$2,664	$2,884	$3,116	$3,361	$3,374	$3,368	$3,341	$3,289	$3,462	$3,640
Addback Depreciation Expense	$731	$780	$850	$911	$974	$1,027	$1,072	$1,108	$1,133	$1,160
Capital Expenditures	3,423	3,508	3,590	3,676	3,289	2,883	2,434	2,003	2,050	2,100
Changes in Working Capital	64	68	70	73	71	65	61	55	54	56
Net Cash Flow	($93)	$100	$305	$523	$987	$1,447	$1,698	$2,339	$2,491	$2,644

Discount Rate	9.28%
Future Growth Rate	2.40%
Capitalization Rate for Terminal Value	6.88%
Net Present Value of FY 2006 - 2015 Cash Flow	6,462
Terminal Value	39,357
Net Present Value of Terminal Value	17,708
Enterprise Value as of August 2006	24,169
Less Working Capital	794
Value of Tangible and Intangible Assets	$23,375

Market Approach

The comparable sales method under the market approach involves review of recent sales of similar facilities between a willing buyer and a willing seller, who are unrelated, as an indication of the general market price for such facilities. Caution must be exercised when using the comparable sales method as an indicator of value for utility property. Normally, the appraiser will, when necessary, make adjustments to the comparables in order to correlate the sales price to the characteristics of the subject property. However, there are many factors that can influence sales price including, among others, market area, age and other considerations that may be reflected in the sales price. Each party's motivation can affect the negotiation and the terms of the sale. Strategic objectives are the driving motivator for some sales. These objectives are often kept confidential and are not available to an appraiser for evaluation.

The comparable sales method is primarily applicable to property that is readily substitutable and where a number of similar type properties have recently been sold. To be an indication of market value, these sales must also involve a willing buyer and willing seller. The market approach is difficult to apply in valuing utility property due to the lack of comparable utility sales transactions.

The market approach was not relied upon in this appraisal due to the lack of utility sales transactions that are comparable to the Subject Property.

Section 6
CONCLUSIONS

Based on the results of our analyses and the limiting assumptions and conditions described in this report, R. W. Beck developed indicators of value using generally accepted approaches to valuation. These indicators of value are summarized in Table 6-1 below.

Table 6-1
Summary of Indicators of Value
as of September 1, 2006

	Indicators of Value
Cost Approach:	
Original Cost Less Depreciation (OCLD)	$23,845,400
Reproduction Cost New Less Depreciation (RCNLD)	$31,155,200
Net Book Value	$12,087,500
Income Approach:	
Rate Base Value	$12,161,600
Direct Capitalization of Income	$17,188,500
Discounted Cash Flow (DCF) Value	$15,567,000
DCF Value with SELA proposed rate increase	$23,375,000
Market Approach:	Not relied upon
Total Fair Market Value as of September 1, 2006	**$20,200,000**

In this complete appraisal, R. W. Beck has considered and examined all three generally accepted approaches to valuation, i.e., the cost, income and market approaches to value.

As discussed in this report, the OCLD and RCNLD indicators of value establish the lower and upper range of value for utility property. For other types of property, what it cost to build the property may not have much bearing on the current fair market value of the property. However, for rate regulated utility property, such as the Subject Property, the OCLD value is a relevant indicator of value under the cost approach because the OCLD value is generally equivalent to the rate base value of the property for utility ratemaking purposes. Under standard ratemaking procedures, rate regulated utilities are only allowed to earn a fair and reasonable rate of return on their OCLD rate base; operating expenses are essentially a pass-through cost recovered through rates. Thus, in theory, one would expect the income value for rate regulated utility property to be close to or equal to its rate base value since this is the value of the utility's investment on which it is allowed to earn its authorized rate of return or profit.

In evaluating the indicators of value developed in this appraisal, the OCLD, rate base and income indicators of value have the greatest relevance for determining the estimated fair market value of regulated utility property for the reasons discussed above.

The direct capitalization of income and DCF indicators of value developed under the income approach produced results in the range of $16 million to $17 million. The outcome of SELA's rate request before the LPSC is uncertain; therefore, less weight was placed on the results of the DCF analysis with SELA's proposed rate increase.

The rate base value of the System as of December 31, 2005 is approximately $12 million. Under LPSC rate regulation, this is the value of the System on which SELA (or another private utility owner) is allowed to earn a rate of return. The LPSC, like other state regulatory commissions, does not allow a paid acquisition premium to be included in rate base and recovered through rates. The rate base value shown in Table 6-1 is essentially equivalent to the net book value of the System.

The OCLD value provides an independent estimate of the rate base or net book value of the System. As shown in Table 6-1, the OCLD value ($23.8 million) is substantially greater than the rate base or net book value. Possible reasons for the difference in value are discussed in Section 5. The OCLD value is based on inventory quantities and cost estimates that R. W. Beck reviewed and/or developed itself. We do not have information regarding SELA's past accounting practices. In valuing SELA, we gave more weight to the estimated OCLD value than the calculated rate base value.

In our opinion, the fair market value of the SELA System is in the range between the income value and the OCLD value. Another private buyer of the System would be subject to the same LPSC rate regulation as SELA and thus would consider the regulated income value of the System, estimated to be $16 million to $17 million. A public (government) buyer would also consider the regulated income value of the System and offer a price that was just enough higher than the next best offer in order to succeed in purchasing the System. In this case, the income value is less than the OCLD value ($23.8 million), although greater than the rate base value. The midpoint of the income and OCLD range of value is approximately $20.2 million.

The market approach was not relied upon due to the lack of relevant utility sales transactions that are comparable to the Subject Property. However, the indicated fair market value of $20.2 million is equal to 1.67 times the net book value of the System.

In our opinion, the fair market value of the SELA System as of September 1, 2006 is equal to **$20,200,000.**

Appraisal Certification

I, the undersigned, certify that, to the best of my knowledge and belief:

- The statements of fact contained in this report are true and correct.
- The reported analyses, opinions, and conclusions are limited only by the reported assumptions and limiting conditions, and are unbiased professional analyses, opinions, and conclusions.
- R. W. Beck has no present or prospective interest in the properties that are the subject of this report, and R. W. Beck has no interest or bias with respect to the parties involved.
- Compensation is not contingent upon the reporting of a predetermined value or direction in value that favors the cause of the Client, the amount of the value estimate, the attainment of a stipulated result, or the occurrence of a subsequent event.
- The appraisal report is not based on a requested minimum valuation, a specific valuation, or the approval of a loan.
- The analyses, opinions, and conclusions were developed, and this report has been prepared, in conformity with the Uniform Standards of Professional Appraisal Practice (USPAP) promulgated by the Appraisal Standards Board of the Appraisal Foundation and the Principles of Appraisal Practice and Code of Ethics of the American Society of Appraisers.
- The American Society of Appraisers has a mandatory recertification program for all its Senior Members and I am in compliance with that program.
- Representatives of R. W. Beck made a personal inspection of the property that is the subject of this report.
- R. W. Beck support staff, under the principal supervision of the undersigned, provided assistance in the preparation of this report. A list of significant contributors is included in the report.

Respectfully submitted,

R. W. BECK, INC.

Prepared under the direction of:

Nancy Heller Hughes, ASA

October __, 2006

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