

SOUTHERN MONTGOMERY COUNTY MUNICIPAL UTILITY DISTRICT

NOTICE OF NEW GROUNDWATER REDUCTION (SURFACE WATER) FEE

Dear Customer:

Effective August 1, 2010, all Southern Montgomery County Municipal Utility District ("SMCMUD") customers will pay an additional fee for water service in the amount of \$0.56 per 1,000 gallons of water used. This will be listed as a separate line item on your bill starting in October. This is not a change in the District's water and sewer rates but an additional fee that will be passed along to another governmental entity to pay for conversion of Montgomery County water systems from groundwater to surface water. All SMCMUD customers currently receive groundwater from four wells that pump from underground aquifers. The new fee has been imposed due to new state and local regulations that mandate that all large groundwater users, including SMCMUD, reduce their dependence on this groundwater. We are sending this newsletter to inform you of these developments.

You may have read news coverage regarding the efforts to bring surface water to Montgomery County. The Lone Star Groundwater Conservation District ("Conservation District") was created by the state legislature in 2001 to conserve, protect and enhance the groundwater resources of Montgomery County. SMCMUD is subject to regulation by this Conservation District, as are all other large volume groundwater users in Montgomery County. The Conservation District determined through scientific studies that groundwater demand in Montgomery County already exceeded what the aquifers could sustainably yield. The Conservation District adopted regulations to require groundwater users to make long-term plans for alternative water supply, and the Conservation District specifically mandated that groundwater users reduce aquifer demands by January of 2015.

SMCMUD investigated all its alternatives and determined that the most cost-effective solution was to join with other large groundwater users in Montgomery County in preparing its long-term plan. The San Jacinto River Authority ("River Authority") is the largest permitted groundwater user in Montgomery County by virtue of its operation of The Woodlands wells. The River Authority also owns sufficient surface water rights in Lake Conroe in Montgomery County to make a county-wide solution possible. The River Authority developed a joint groundwater reduction plan and offered it to all the Montgomery County groundwater users. The majority of large volume groundwater users in Montgomery County have elected to participate with the River Authority and so has SMCMUD.

If the River Authority adheres to its proposed plan, the customers of SMCMUD should not expect to receive surface water during the first phase of compliance in 2015. However, customers of SMCMUD will be required to pay for the surface water solution, which will benefit SMCMUD, as well as everyone in Montgomery County.

The most noticeable benefit of joining with other users in a regional solution is the ability to achieve significant cost savings by utilizing a group compliance approach. Some large volume users will be wholly or partially converted to surface water, while other

participants will remain 100% on groundwater, achieving county-wide compliance with the 30% reduction by the 2015 deadline. By reducing groundwater pumpage, stress on the aquifers will be reduced and water tables can recover and recharge. Existing wells can then pump at capacity until the majority of water systems are converted to surface water over the next 25 years.

SMCMUD has entered into a contract with the River Authority for groundwater reduction planning. According to the contract's terms, SMCMUD will be required to pay a pumpage fee to the River Authority, and the River Authority will use this money to prepare and implement the regional solution, including construction of lines and water treatment plant facilities. The River Authority will begin to assess this fee to all of its contract customers, including SMCMUD, effective August 1, 2010. The Board of Directors of SMCMUD has determined that the assessment must be passed on to its customers, and this fee will appear as a **separate line item on your monthly bill starting in October.**

It is too early in the operation of the River Authority's surface water conversion efforts to speculate on the level of assessments in the future, but we do anticipate that the assessments will increase over time. SMCMUD's rate structure to its customers is set up to increase automatically whenever rate increases are enacted by the River Authority. We will keep you informed of future rate changes as soon as we receive notice from the River Authority. Please check our website at www.smcmud.com for the most current updates regarding this matter.

SMCMUD must pay this fee for every gallon of water that we pump. Lost water is a significant expense for SMCMUD. We encourage you to be proactive in helping us to locate and repair leaks. Anyone who observes a water leak, open manhole, missing meter box, or other problem with the water or sewer system should call SMCMUD's office at 281-367-5383.

Water conservation will also continue to be very important. We send you educational materials from time to time on ways to reduce water consumption, and we urge you to continue your efforts in this regard. Lowering your own water consumption will reduce your household expenses and help preserve our most valuable natural resource – water.

Regularly scheduled meetings of SMCMUD's Board of Directors are held the third Wednesday of each month at 7:00 p.m. at the SMCMUD office at 25212 Interstate 45 North, Spring Texas. Meetings are open to the public, and we encourage you to attend and stay informed about your MUD's business.

Sincerely,

BOARD OF DIRECTORS
SOUTHERN MONTGOMERY COUNTY
MUNICIPAL UTILITY DISTRICT