

City of Hesperia

STAFF REPORT



DATE: March 7, 2017

TO: Chair and Board Members, Hesperia Water District

FROM: Nils Bentsen, City Manager

BY: Michael Blay, Director of Development Services
Tina Souza, Management Analyst

SUBJECT: Permanent Water Rights Purchase from Lounsbury/JPMorgan Chase

RECOMMENDED ACTION

It is recommended that the Board of Directors of the Hesperia Water District 1) authorize the purchase of 181 acre-feet of permanent Base Annual Production water rights in the Alto Subarea from Carolyn Lounsbury and JPMorgan Chase BK, National Association Co on behalf of Bank of America for \$4,200 per acre-foot; 2) authorize the lease of 145 acre-feet carryover rights for \$276 per acre-foot, for a combined total amount of \$800,220; and 3) authorize the City Manager to execute all documents related to the purchase and lease transactions.

BACKGROUND

The Adjudication (City of Barstow et al, v. City of Adelanto et al) is intended to remediate overdraft in the Mojave Basin Area by limiting the amount of water produced in specific subareas. The Free Production Allowance (FPA) is the maximum amount of water a producer may pump in one year without incurring a replacement or make-up obligation. As a result of the judgment, Hesperia Water District (District) incurs replacement water obligations in the Alto Subarea when verified production amounts exceed the FPA for the water year.

The District may meet these replacement water obligations by three mechanisms: 1) assignment of carryover right or temporary transfer of unused FPA (i.e. lease) from interested water rights owners in the respective subarea at negotiated rates (this is a cost effective short-term option to meeting the production demands); 2) purchase water from the Mojave Basin Area Watermaster (Watermaster) at the current per acre-foot (AF) water rate which is derived from the State Water Project water rates, and/or; 3) purchase permanent water rights from interested parties in the Alto Subarea at negotiated rates (purchase provides a long-term solution, but is costly and difficult to acquire).

Historically, the District has been able to meet a large portion of its replacement utilizing the assignment of carryover right, or temporary assignment mechanism and will continue to do so when agreements with water rights owners can be secured. However, permanent water rights are purchased from private parties when there is a feasible opportunity. With the growing demands of the District's service area, water availability, and the competitive nature of assignment water, the balance of the replacement obligation has been met by purchasing water from the Watermaster each water year, or more recently utilizing Inventory Claim/Pre-purchased water from the Watermaster.

A representative from the law firm of Caufield & James, representing Carolyn Lounsbury, as well as a local realtor, expressed that Carolyn Lounsbury and JPMorgan Chase BK, National Association Co on behalf of Bank of America (Chase), had interest in selling 181 AF of permanent Base Annual Production (BAP) water rights, as a result of litigation between Lounsbury and Chase. Due to the ramp down of 60 percent required by the Adjudication, the BAP equates to 109 AF of FPA that can be used to offset annual replacement obligations. The parties also expressed interest in leasing 145 AF of Carryover rights to the District, which equates to 109 AF that may be applied to Water Year 2016-17 replacement obligations.

ISSUES/ANALYSIS

During the 2015-16 Water Year (October 2015 to September 2016), the District produced 13,207 AF of water. The District's FPA is 8,232 AF leaving a replacement obligation of 4,975 AF. The City owns 6,736 AF which equates to 4,042 AF of FPA that can be used to offset annual replacement obligations by leasing to the District; subsequently leaving a replacement obligation balance of 933 AF (based on 2015-16 Water Year's production). The purchase of permanent water rights, while costly, provides a long-term solution to the inevitable water production overrun the District faces annually.

The table below represents the City's and District's historical purchases of permanent water rights. More recently, permanent water transactions among other parties approved by the Watermaster within the past two years were at \$5,000 per AF.

MM/YY	Purchased From	Acre Feet Purchased	Cost Per Acre Foot
Feb-2012	Summit Valley Ranch	40	\$ 4,010.00
Jul-2012	Summit Valley Ranch	25	\$ 4,035.00
Dec-2012	Rancho Las Flores (R.E. Loans)	5,971	\$ 5,024.28
Mar-2014	Summit Valley Ranch	200	\$ 5,000.00
Apr-2015	Aqua Capital	500	\$ 5,000.00
Oct-2015	Jerry Cunningham	9	\$ 5,000.00
*Feb-2016	Jerry Cunningham	10	\$ 4,700.00
*Oct-2016	Carron Abbott	12	\$ 4,300.00

*Purchased by the Water District.

Opportunities to purchase permanent water are scarce. Pursuant to Carolyn Lounsbury and Chase's interest in selling 181 AF of BAP right, staff began negotiations to purchase the water rights. Staff was able to negotiate a lower rate than that of the October 2016 transaction and historic transactions dating back to the acquisition of Rancho Las Flores water rights in 2012.

In an effort to obtain future water supply, staff recommends the purchase of 181 AF of permanent BAP water rights in the Alto Subarea from Carolyn Lounsbury and Chase at \$4,200 per AF for a total of \$760,200, as well as lease 145 AF of Carryover rights at \$276 per AF for a total of \$40,020, which combined totals \$800,220.

Attached to this staff report is a draft Water Rights Purchase and Sale Agreement and Escrow Instructions, which is under review by the selling parties' legal counsel. The draft agreement is subject to minor revisions; however, if modifications are warranted that substantially deviate

from the terms or intent of the agreement, staff will bring the agreement back to the Board of Directors.

FISCAL IMPACT

Should this purchase of 181 AF of permanent BAP water right be approved, a budget amendment of \$800,220 will be included in the Year End budget review.

ALTERNATIVE(S)

1. Provide alternative direction to staff.

ATTACHMENT(S)

1. Draft Water Rights Purchase and Sale Agreement.