

# *Trading* Water

DEVELOPMENT IN ARIZONA IS ON THE REBOUND. WHO'S GOING TO KEEP THE WATER FLOWING? AND AT WHAT COST?

**By Tom Marcinko**





# A S OF THIS MINUTE, THE PRICE OF A BARREL OF OIL IS \$93.49. IT'S LISTED ON THE NEW YORK MERCANTILE EXCHANGE. IT'S REPORTED IN THE NEWS. EVERYBODY AGREES ON IT.

As of this minute, what's the price of a unit of water? Well, if you're a member of certain Native American communities in Arizona, it might be \$25. If you're the Palo Verde nuclear plant near Phoenix, it's about \$300. If you're a water development company with sights on Prescott Valley, it could approach \$25,000. Confused? Welcome to the world of water rights deals.

We tend to think of water as a public resource, free from the vagaries of market forces. More than 90 percent of Americans get their water from publicly controlled systems, and many people feel that's how it should be. "Water is essential. I don't think we should entrust it to water brokers," says Sandy Bahr, director of the Sierra Club's Grand Canyon chapter.

But throughout the Southwest, it's become increasingly common for water to be bought and sold at auctions in multi-million-dollar deals. Market consultants predict we'll see even more water privatization in the future. National water development and investment companies like Aqua Capital Management, Water Asset Management, and Vidler Water Company are quietly capitalizing on liquid cash. Some flip water resources like real estate sharks; some broker deals like pawn shops; some do the heavy work of sleuthing out water sources, buying them from government entities, building infrastructure, and selling the H<sub>2</sub>O to developments.

Like crude oil, water becomes more valuable as it becomes scarcer. And it is becoming scarcer. According to a recent study, the Southwest's population boom, coupled with persistent drought and climate change, will lead to a water deficiency on the Colorado River of more than 1 trillion gallons annually by 2060. What will decreasing water coupled with increasing privatization mean for the average Arizonan's water bill? How will voters and ratepayers react to corporate ownership of water? Should governments even allow a life-sustaining resource to be vulnerable to price gouging? Whatever the answers, one thing is certain: The real cost of water is about to hit home.

**S**an Diego-based water investment company Summit Global Management takes its motto from Benjamin Franklin: "When the well's dry, we know the worth of water." Summit consultant Steve Maxwell has a saying, too: "If [water] has no value, we treat it like it has no value." University of Arizona professor Robert Glennon agrees. In his 2010 book *Unquenchable: America's Water Crisis and What To Do About It*, he says Americans are encouraged to waste millions of gallons of water because of low prices. The average American household gets four gallons of water for a penny. Glennon - and many others - say we need to start paying what water is really worth. But how much is that?

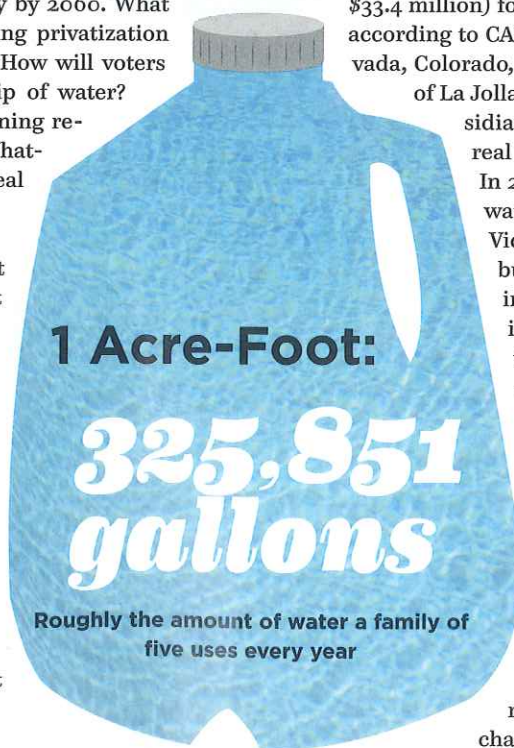
Water is measured in acre-feet (AF): one acre across, one foot deep. It's 325,851 gallons - the average amount of water used every year by a family of five. Phoenix downs about 100 billion gallons, or 306,000 AF, every year. In Arizona, the price for municipal water fluctuates, but \$145 per AF is not unusual, according to David V. Modeer, general manager of the Central Arizona Project (CAP), which provides about 40 percent of the state's water.

But water can fetch pails more money. In 2007, Prescott Valley auctioned off 2,724 AF of its recycled water for \$67 million. That's \$24,650 per AF. The buyer was Water Asset Management, a New York City investor in water companies. A condition of sale: Keep that water in town for re-sale to future developers, says town manager Larry Tarkowski. Omaha-based Aqua Capital Management, which has handled more than 500 water-rights transactions in the U.S., arranged the auction and guaranteed the town a buyer. If the water didn't sell at auction, Aqua would buy it for \$53 million.

But another water company is taking the reins in Arizona.

For a glimpse into the possible future of our state's water, take I-10 over the Maricopa County line to La Paz. There, on 460 acres, sprawl the green rectangles of the Vidler Recharge Storage Facility. The site can store up to 1 million AF. Now it's about a quarter full. The vault belongs to the Vidler Water Company, a La Jolla, California-based corporation that's been buying billions of gallons from CAP for about 15 years. Nearby, the company owns nearly 9,800 more AF. And at five sites in the Phoenix area, Vidler stores another 157,000 AF. All told, Vidler paid a relatively low \$78 per AF (about \$33.4 million) for a total Arizona water pool of 427,351 AF, according to CAP. Vidler - which also has projects in Nevada, Colorado, New Mexico, and Idaho - is a subsidiary of La Jolla-based Pico Holdings, one of whose subsidiaries was once the largest private holder of real estate in Nevada, with 1.2 million acres. In 2012, Pico pegged its total real estate and water holdings at \$342.3 million. Most of Vidler's water in Arizona is now waiting for buyers - and almost certainly accumulating value while it waits. Assume two big ifs: that Vidler could sell its Arizona water today, and that \$145 per AF is a reasonable yardstick. If so, Vidler's Arizona water would be worth about \$61 million.

Depending on future demand, though, it could be worth more. Water's value is fluid. It depends on where the water is, how big the supply, how urgent the demand, and lots more - including who owns it. The line between public and private ownership can be fluid, too. Colorado River water starts out as public property, but before it reaches faucets, it winds through a flow-chart of bureaucratic and political channels





- managed by soft-spoken people who drop legalisms like "usu-fruct" and "fungible" in polite company - as well as owners including private utilities.

Vidler is not a utility. It buys and sells water for profit - but company president and COO Dorothy Timian-Palmer is quick to correct a reporter who asks about brokerage and speculation. She distances her company from firms like Aqua Capital or Summit Global. "We're not just someone who goes in and buys water resources that are already developed, holds them, and then flips them," she says. "We don't do that." So what *does* Vidler do? "We develop water resources, we employ people." Vidler's customers, she says, have a practical, concrete need for water. "We have a project before we go into an area."

How Vidler acquired Arizona water stems from the complex way water is handled in the Southwest. The Southwestern states have been fighting over water since the 1920s, when the seven Colorado River Basin states and Mexico signed the seminal Colorado River Compact. The federal government now referees that fight, via a complex mechanism of regulations, lawsuits, and interstate agreements. By the time the Colorado trickles into Mexico, it's practically dry.

The U.S. Department of the Interior lets Arizona have 2.8 million AF of Colorado River every year. CAP divvies it up between agricultural, municipal, and other users, delivering it to Pima, Pinal and Maricopa counties via a 336-mile canal. The Arizona Water Bank stores unused water for emergencies in six facilities, most near Phoenix. Modeer says the banked water could see the state through a four-year drought. It isn't for sale and has never been tapped, says CAP water-control manager Brian Henning. In a drought, CAP's first priority would be drinking water, he adds.

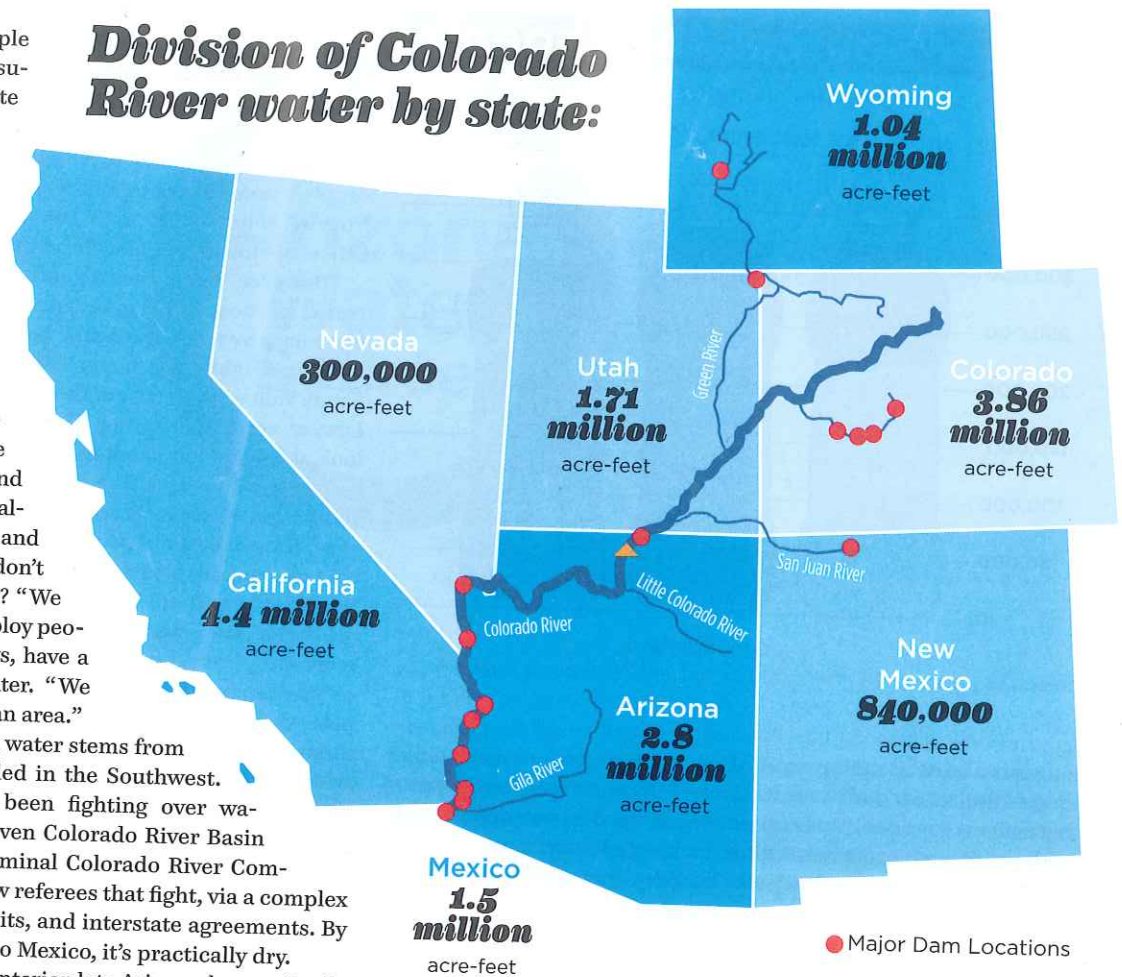
For years the Bank was full to the brim. As a result, CAP had "excess" water on its hands - about 832,000 AF in 2009. It would be a shame, CAP reasoned, to let the feds liberate Arizona's unused Colorado dole and give it to California - for free. It's been known to happen, Modeer says: "California, prior to the development of the CAP [online since 1993], was already using a portion of Arizona's Colorado River allocation. The amount varied year to year but was in the hundreds of thousands of acre feet."

To keep the excess water in Arizona, CAP held an annual sale to farmers, municipalities, Native American communities, and - last served - dozens of private companies like Resolution Copper Mining, Rosemont Copper, and Vidler. Now, rising demand for the wet stuff has dried up CAP's excess supply, Modeer says. But up to 2009, CAP was happy to sell excess to Vidler, Timian-Palmer says. "They didn't want the water to go to California. So we met a need. And now... CAP doesn't want us here any more."

"That is her opinion," Modeer says. "We do not have a negative view of Vidler or others who are the same type of business. We only require that business transactions are in accordance with Arizona law."

Sometimes, Vidler's staff of 15 engineers, geologists, hydrologists, and archeologists explores and discovers new water sources, as they have in Nevada and Colorado. More often it drills for known

## Division of Colorado River water by state:



water supplies and builds the wells, pipelines, tanks, booster pumps, and other hardware needed to move water.

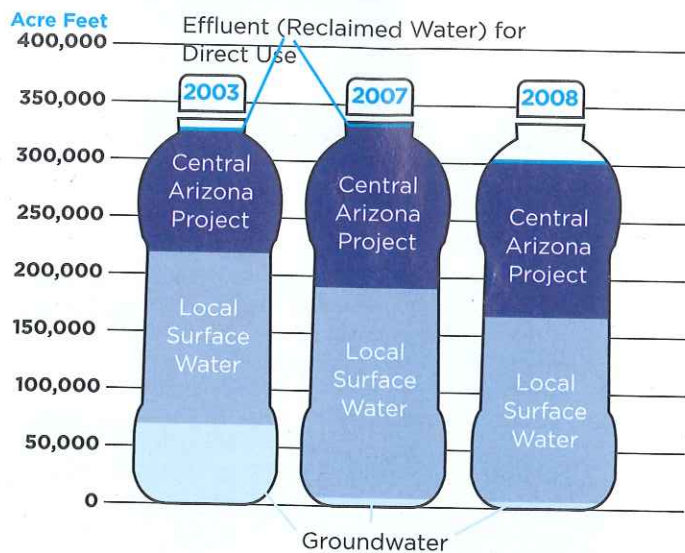
Vidler will help municipalities avoid hitting up today's ratepayers for tomorrow's development, Timian-Palmer says. "Governments are risk-averse and understandably reluctant to incur the typical risks associated with the development of water resources, especially if it is to support new development."

For example, in Washoe County, Nevada, Vidler built an \$85 million water-storage facility and gave it to the county to own, maintain, and operate. Vidler gets a place to store 8,000 AF it can sell. As for Washoe: "We got valuable facilities that would have facilitated and supported planned development," says Rosemary Menard, county director of water services. "We did not have to do the planning, negotiating, permitting, engineering, design or construction of these facilities." It probably would have looked like a better deal if building activity hadn't evaporated around 2005. The recession has run Nevada's water pricing over rapids, from about \$30,000 per AF in 2006 to \$8,740 now, according to Mark W. Foree, general manager of the Truckee Meadows Water Authority.

A major part of Vidler's business model, though, just involves buying and selling water. For example, two golf clubs in Scottsdale - Desert Mountain and Golf Club Scottsdale - will pay Vidler almost \$10 million to deliver water. The city now waters the clubs' seven courses but requires them to have a backup supply. A decade ago, the clubs bought a water farm 13.5 miles from the CAP canal, but building a pipeline that distance would cost an estimated \$30 million. The closer water source they purchased from Vidler will instead require building a two-mile pipeline for an estimated \$4 million. The golf courses will get 1,650 AF. Scottsdale wanted a fee for the transaction but instead decided to take it out in trade, to the



# Water Sources for Phoenix



tune of 1,260 AF. Henning says CAP can't determine how much Vidler originally paid for that water, but at the \$78 per AF rate, it would have been about \$227,000. Timian-Palmer says the deal was done strictly with private money, so it won't hike residential water rates.

The go-between for the deal is Timothy Bray, who does business as Southwest Community Resources. He calls himself a water-resource consultant, though he has no problem with the term broker. "I act like a real-estate broker. I will enter into an agreement with one side or the other to do this work, and so I get paid by one side or the other just like any broker would get paid." Bray resigned from CAP's board of directors last year because, he says, he needed to devote more time to his business. He says he estimates his fee for the Scottsdale deal at about \$300,000, typical of real estate brokers.

Won't this wheeling and dealing eventually inflate the price of water? Timian-Palmer says the market calls the tune, and Vidler won't price itself out of the market. Also, what Vidler charges is only part of the picture, she says. Keeping water clean and infrastructure humming also affects what ratepayers pay, and the municipal-ity sets those rates, she adds.

Thomas Buschatzke, assistant director of water planning for the Arizona Department of Water Resources (ADWR), agrees that market forces have much more impact on prices than a single company's decisions. "There is an opportunity for companies like [Vidler] to fill a need. They're risking their capital for some future return on their investment," he says, adding that Arizona is a "level playing field," and Native American communities and municipalities with long-term contracts with CAP "can do the exact same thing that Vidler can do. They can create a long-term storage credit and sell it on the market for whatever price they want to sell it."

But if Vidler and other companies can't control the market, they do influence it. Market forces include negotiating savvy and clout, in pursuit of the best deal. Eventually somebody has to cover rising prices, even if it's not always possible to point to a smoking faucet.

In Prescott Valley, "New subdivisions that rely on auctioned water will end up having the cost of the water resource built into the home," says town manager Tarkowski. Higher water rates will also be reflected in the cost of a home in places like Washoe County, Nevada, when and if development returns, Foree says.

Clark County, which includes Las Vegas, eyes its neighbors' water the way California covets Arizona's. Beginning in 1998, the City Where What Happens Stays tried to gulp 200,000 AF from neighboring Lincoln County. Vidler bought it first, for \$27 million. Lincoln benefitted, says Wade Poulsen, general manager of the county's water district. "Otherwise we could have been gobbled up from the Southern Nevada Water Authority [SNWA] back in the day." Others complain that Lincoln ceded control of its water to Vidler.

However, Vidler does not always get its way. Witness what happened in 2004, about 35 miles south of Vegas. Timian-Palmer says her company was approached by the town of Primm to develop the water in neighboring Sandy Valley. The deal never happened. Some Sandy Valley residents got the state supreme court to stop the sale. Lawyer and ranch owner Al Marquis tells why: "[Vidler officers] look at how much is being used and determine, well, there's this many extra acre-feet. So basically Vidler takes the position that 'we should get whatever's extra'... Well, you know, when you use up every drop of available water, it's very possible that there's a miscalculation and people's wells are going to start running dry." Timian-Palmer shrugs it off. "Sometimes people don't like what water will get them," she says. "That might be a neighbor next door, a development."

The company hit similar snags in White Pine County in 2002. Both Vidler and the Vegas-backed SNWA approached the county to buy about 200,000 AF. The county turned down both players. Former county commissioner Gary Perea is glad: "I have a problem with Vidler Water, where they're buying up a natural resource that I believe should belong to everybody and be put to good use and should not be used to profit from."

"Water rights are a private property right throughout the West generally, but specifically in Nevada," Timian-Palmer responds. "I don't believe that farmers and ranchers, and any other water right holders throughout the West, would appreciate Mr. Perea's statement that their property rights belong to 'everyone' and that farmers, ranchers and other water-right holders have no right to make a fair profit from their use of water."

Others in White Pine wish they'd sold the water to Vidler. Another ex-commissioner, Mike Lemich, says White Pine's H<sub>2</sub>O is still vulnerable to being slurped up by Vegas.

The news for Vidler wasn't all bad in White Pine, though. In 2000, Vidler bought a 7,150-acre ranch - and its water rights - for \$4.5 million during a bankruptcy sale. In 2006, it sold the property to SNWA for \$22 million, about five times its purchase price. Patricia Mulroy - still general manager of SNWA - said at the time her organization got a fair deal for the water.

In the early 2000s, water rights in Washoe shot up from about \$4 per AF to \$60 due to a bidding war between developers, according to Menard. "I would not blame Vidler," Foree stipulates. But do water development companies - by their very presence, like a powerful commercial gravity field - affect water prices?

The average Lincoln County bill for water and sewer is about \$55 a month, Poulsen says. That's comparable to the average monthly water-sewer bill of \$58.46 in Phoenix. In Washoe County, the drinking water rate varies by month, averaging about \$70, plus a flat \$38 rate for sewer. \$108 seems high, but Menard says: "Everything is relative... Perhaps it is not that we're high, it is that Phoenix is low."

How, or if, Vidler will affect water rates in Arizona is likewise unclear. As with many companies, the recession stalled its progress in Arizona, so we don't yet have an example of a local Vidler-fueled development. It's not even clear who will buy Vidler's water, though it seems likely that Phoenix would belt it down like a thirsty cyclist clutching a Bloomberg-mocking Big Gulp. "My cities are looking for renewable water supplies that will be there year in and year out,"

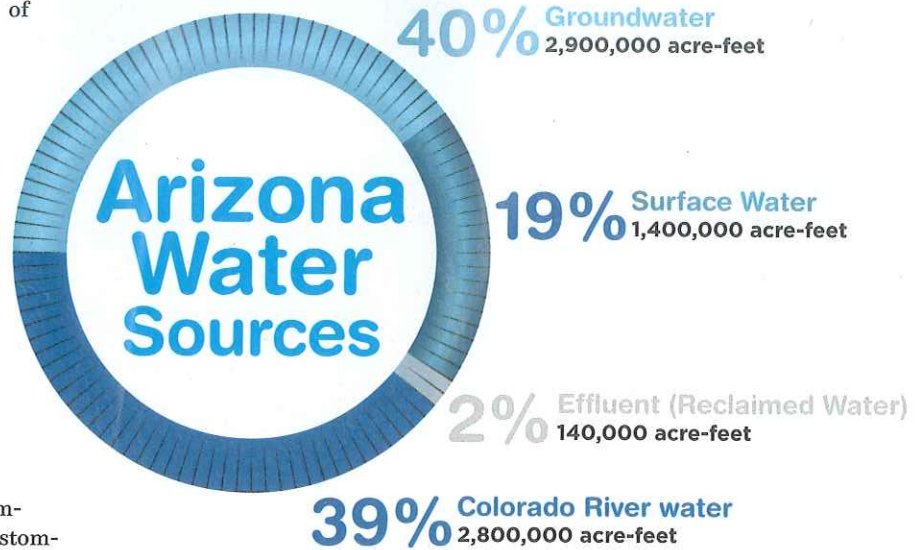


says Kathleen Ferris, executive director of Arizona Municipal Water Users Association (AMWUA), which represents Phoenix, Scottsdale, and eight other municipalities. "Each city has to demonstrate it has enough water to meet the needs of its customers for 100 years. [But] the kind of supplies that Vidler has [will] only last a certain number of years, depending on how much you use in a year."

An East Valley water official asked to have his name withheld because he doesn't want to jinx a possible deal with Vidler, which approached him about two years ago, during the recession. "Their timing could not have been worse," he says. With the economy now improving, he says he expects Vidler to find customers in Arizona.

As the Southwest's rivers dwindle, Vidler's 400,000 AF of Arizona liquid represents future profit and influence – it's hard to imagine the price going anywhere but up. But CAP's shrinking water supplies mean Vidler's future as a *buyer* is less certain. Vidler might tap Arizona sources outside metro Phoenix, Henning says, but for complex legal and regulatory reasons, it could be difficult and pricey. In addition, Pico might build a power plant near the La Paz facility, according to the company's yearly report to the U.S. Securities and Exchange Commission. Prescott Valley put out feelers about building a water facility, says Jeffrey A. Sandquist of Phoenix lobbying firm Veridus, Vidler's voice in Arizona.

Vidler and Pico pride themselves on being savvy about law, reg-



ulation, and politics. Vidler has paid the firm of Akerman Senterfitt to lobby Congress and the Interior Department for about 10 years, spending a high of \$105,000 in 2008 and about \$40,000 in 2011-2012. Arizona public records show Timian-Palmer herself donated about \$2,500 to 10 legislative candidates in 2000, including Brenda Burns, who now serves on the Arizona Corporation Commission; state senator Gail Griffin; and the late House Speaker Jeff Groscost.

Vidler is now "monitoring" the progress of a bill by House Speaker Andy Tobin that would create and fund "regional water authorities" – public-private partnerships that could, among other things, buy and sell water rights. The company has not decided pro or con, Sandquist says. AMWUA director Ferris says her group supports the bill, which she says would help rural areas develop water resources. The Sierra Club says no, partly because the bill lacks conservation provisions. A group of 19 Yumans who feared losing their water traveled to the capitol in February to protest the bill to Tobin, who stood them up, according to the *Yuma Sun*. The bill is dead for this year, but Tobin will probably try again next session.

Other companies, like Aqua Capital, are even quieter about their plans for Arizona. "Our focus is more on developed water rights than developing water rights," says Aqua's Craig Bush, suggesting that buying and selling in the state will continue.

Even in fiscally conservative Arizona, you might expect privatization of a natural resource to be a hot issue. What if we suffered a major drought? Then, says Timian-Palmer: "Every owner of water rights in Arizona would have the opportunity to sell their assets at whatever market value might be at the time. However, price-gouging is not conducive to a long-term business plan."

U of A's Glennon believes access to water for drinking and bathing is a human right, but watering your lawn or washing your car during a drought is not. "I'm a big fan of water marketing," he says. "It's clear that all water is going to become much more valuable over time. It's just a question of how quickly. And I myself have no problem with people trying to move in there and make some money."

Nevadan adversary Al Marquis' advice to Arizona about Vidler: "Watch them carefully." Timian-Palmer says Arizonans should do just that. "I think you're going to see that we meet a need." But, she concedes, as if steeling herself for a rocky future, "Water's always going to be an emotional issue."

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## 2008 Water Use in Phoenix

