



COLORADO

**Colorado Water
Conservation Board**

Department of Natural Resources

1313 Sherman Street
Denver, CO 80203

P (303) 866-3441
F (303) 866-4474

John Hickenlooper, Governor

Mike King, DNR Executive Director

James Eklund, CWCB Director

TO: Colorado Water Conservation Board Members

FROM: Tim Feehan, Deputy Director, Resource Management

DATE: November 19-20, 2014 Board Meeting

AGENDA ITEM: 28c - Changes to Existing Loans
Pagosa Area Water and Sanitation District
Dry Gulch Reservoir Loan Restructuring

Introduction

Over the past five decades, the Pagosa Area Water & Sanitation District (PAWSD), in conjunction with the San Juan Water Conservation District (SJWCD) and the Southwestern Water Conservation District (SWCD), has been evaluating the long-term water needs of the area, potential water supplies and storage sites. A 1989 supply and demand study indicated a storage need of approximately 12,000 acre feet to meet PAWSD's current and future growth projections through 2040. The study also inventoried and reviewed 13 potential reservoir sites within Archuleta County, determining that the Dry Gulch Reservoir (Project) site was the most feasible.

In January of 2008, the CWCB approved an \$11,217,000 loan from CWCB to PAWSD to finance the purchase of land for the future site of the Project. The loan represented 90% of the estimated acquisition cost of the Weber Parcel, also known as the Running Iron Ranch (660 Acres) and the Lavery Parcel (150 Acres).

In 2009, PAWSD and SJWCD acquired the Running Iron Ranch at a purchase price of \$10,219,363, with a \$9,219,363 loan from CWCB, and a \$1,000,000 grant from the SJWCD from proceeds that came from Basin and Statewide WSRA funds. After the purchase of the Running Iron Ranch, the economy worsened and the Colorado Supreme Court issued its opinion reducing the Project from 35,000 AF to 11,000 AF. The PAWSD's Board began to re-evaluate the timing and its long-term financial commitment to the Project. Given PAWSD's uncertainty in proceeding with the Project, it elected not to pursue the purchase of the Lavery Property.

In August 2012, CWCB staff notified the District that the Loan Contract's "Time of Performance" was going to expire on September 18, 2012. The staff offered the District two options: extend the "Time of Performance" to allow more time to develop a plan to utilize the remaining loan funds to purchase the Lavery Parcel or to close out the loan and begin repayment.

PAWSD elected not to pursue any additional land purchases and closed out its loan with CWCB. PAWSD has made two annual payments on its loan, in the amount of \$501,269.00, and has a current outstanding balance of \$8,855,930.22.

Over the past 9 months, PAWSD, SJWCD and CWCB have been discussing various options of how PAWSD's existing debt could be restructured to maintain the viability of the Project in light of PAWSD's long-term commitment to storage and short-term financial impact. The proposal being considered would have SJWCD manage the Project, with participation from PAWSD, while providing PAWSD sufficient debt relief to



address its immediate water infrastructure and distribution needs. The intent of the proposal is to provide all entities with the necessary financial flexibility, security, and oversight to allow the Project the necessary time to develop.

Discussion

CWCB has been actively involved in conserving, developing, protecting, and managing Colorado's water for present and future generations. CWCB has been very active in the development of the Statewide Water Supply Initiative (SWSI), Basin Roundtables, Inner Basin Compact Committees, Basin Implementation Plans (BIPs), and most recently the drafting of the Colorado Water Plan. One of the main emphases of the Colorado Water Plan, in conjunction with the BIPs, was to identify projects that addressed basin water supply needs. The Dry Gulch Reservoir Project was identified in the SWSI 2010 final report and has been recently identified in Southwest Basin BIP as a priority water supply project for the basin.

PAWSD and SJWCD have spent a significant amount of time, money and energy in developing the Project over the last decade. Since 2012, the SJWCD has revised and resubmitted a land exchange proposal to the U.S. Forest Service, re-surveyed the pool basin, and taken steps to advance the Project. PAWSD, however, given its current infrastructure and water supply needs, believes it would benefit greatly from restructuring its financial investment in the Project and redirecting the long-term management of the Project to a broader user base. PAWSD still sees the Project as an integral piece to its long-term water supply, but a general reprioritization of its short- and long-term capital water infrastructure investment is a more logical/beneficial approach.

During the initial development of the Project, PAWSD and SJWCD entered into an Amended and Re-stated Inter-Governmental Agreement (IGA), which defined their respective obligations concerning the Project. By letter dated September 24, 2013, PAWSD gave SJWCD notice of termination of the IGA. The IGA was terminated on or about March 23, 2014 because of PAWSD's change in perspective of its long-term water infrastructure needs and priority. Some of the issues that still remain after termination include co-ownership of the 660-acre Running Iron Ranch, shared water rights directly and indirectly related to the Dry Gulch Project, and long-term debt obligations to the CWCB incurred from purchasing the land for the Project.

These remaining issues have been incorporated into a Letter of Intent (LoI) between PAWSD and SJWCD, executed in September of 2014, which defines an acceptable path between the two entities to keep the Project moving forward. A copy of the LoI is attached. Though CWCB is not a party to the LoI, it has been involved in a number of discussions with PAWSD and SJWCD to discuss PAWSD's existing debt with CWCB, collateral, conditional water rights, and future management of the Project, and how these items could potentially be restructured.

Proposal

Maintaining the conditional water rights is extremely important. Without successful diligence on the existing conditional water right, the Project will fail and the community's water needs will not be met. Without active, accountable, and documented participation from PAWSD, the conditional water right will be vulnerable. Though PAWSD is understandably concerned with a long-term financial commitment to the Project, PAWSD's support for the project needs to be strong. Any long-term water supply project is subject to many unknowns, such as permitting, land exchanges, financing, etc., but the need for the Project remains constant and is well documented. Attached is a memorandum from Kent Holsinger, legal counsel to the SJWCD, dated October 13, 2014, summarizing the Project water rights and the environmental benefits of the Project. The conditional water rights for the Project are held by PAWSD and SJWCD.

The LoI attached is an agreement between PAWSD and SJWCD on what would be acceptable terms for both parties to move forward with the Project. The main issues associated with the proposal are: 1) restructuring of PAWSD's existing debt with CWCB, including a principal reduction in exchange for land and an interest rate reduction; 2) mutual protection and diligence on the existing conditional water right for the Project; 3) future management of the Project; and 4) the release of PASWD from any future liability or expense associated with the Project.

The PAWSD loan with CWCB has a current unpaid balance of \$8,855,930.22, at an interest rate of 3.5% for a 30-year term, with an annual payment of \$501,269.00. PAWSD has made two payments. Collateral on the loan is a Pledge of Revenues backed by a Rate Covenant. SJWCD has a \$1,000,000 investment in the land purchase, which was funded by a CWCB Water Supply Reserve Account (WSRA) grant. The WSRA funding contract between CWCB and SJWCD stipulates that if the Project is not constructed by 2020, the \$1,000,000 in granted funds must be repaid to CWCB with interest.

CWCB staff has reviewed the Letter of Intent and would recommend the following conditions, if the Board were to direct staff to move forward with the proposal:

1. SJWCD has provided CWCB with a certified appraisal of the Running Iron Ranch. Upon review and approval of the appraisal by CWCB, PAWSD's existing loan with CWCB will be restructured by reducing the amortized loan amount by the appraised value of the Ranch and applying that loan amortization reduction amount as a balloon payment at the end of the loan. For example, if the land were to appraise at \$4,600,000, PAWSD's new amortized loan amount would be $\$8,866,930.22 - \$4,600,000 = \$4,266,930.22$, with a balloon payment of \$4,600,000 due at the end of the payment period. Security for the amended loan amount would continue to be a Pledge of Revenues back by a Rate Covenant, with the additional collateral of the 660 acre Running Iron Ranch, including PAWSD shares in Park Side Ditch.
2. PAWSD's re-amortized loan balance would be at a reduced interest rate of 1.75% and a reduced term of 20 years. Based on the example above, PAWSD's new annual payment would be \$254,041.69, which would result in an annual savings of \$247,228. CWCB would agree to the interest rate reduction if PAWSD would agree to use 50% of its annual payment savings for the repair and replacement of its aging distribution system to address leakage. PAWSD will provide CWCB with an annual report of how the payment savings are being spent.
3. CWCB, PAWSD, and SJWCD all agree that it is in their best interests to protect the conditional water rights associated with the Project, and pledge cooperation with each other to accomplish this goal. The Letter of Intent attached provides draft wording of how that might be accomplished (see Item No. 5). The CWCB's recommended edits to Item 5 in the Letter of Intent are summarized below:
 - a. The Parties' cooperation includes, but is not limited to: (i) PAWSD agrees to make long-term planning commitments, acknowledging the Dry Gulch Project and its attendant conditional water rights as an **preferred** option; ~~it being understood that such planning commitments do not obligated PAWSD to any future financial commitments to the Dry Gulch Project;~~ (ii) PAWSD agrees to include the Dry Gulch Project in its planning documents as a principal storage option for future water demand growth that cannot be met by existing reservoirs; ~~and~~ (iii) PAWSD commits to an ongoing evaluation of future water purchases from the Dry Gulch Project based on long-term demand projections, an evaluation of costs, **and** viable alternative sources of **existing** water; ~~and consideration of the prospective likelihood the Dry Gulch Project will actually be built and able to provide water to PAWSD~~ (iv) **PAWSD commits that any future water demands will first be met by the Dry Gulch Project, unless those demands can be met with other existing sources; and (v) PAWSD and SJWCD agree to file a joint application for finding of reasonable diligence on the Dry Gulch Project.**
4. The revised 20-year repayment term will become the planning period by which PAWSD and SJWCD must make substantial progress towards construction of the Project. In other words, on the date that PAWSD's loan is amended, PAWSD and SJWCD shall have 20 years from that date to demonstrate steps toward construction or abandon the Project. The Project could obviously move forward quicker, but if after 20 years, PAWSD and SJWCD determine that the Project will not be constructed, the Running Iron Ranch property will be sold. CWCB will first receive payment on any remaining loan balance and the interest lost due to the interest rate reduction

made to PAWSD, and for the \$1,000,000 grant it made to SJWCD. Any remaining funds would go to PAWSD and SJWCD, to be disbursed as agreed by those entities.

5. By restructuring its debt with CWCB, PAWSD agrees that the long-term management of the Project will be led by the SJWCD, given that both entities hold the conditional water right for the Project, and that SJWCD was created to conserve, maximize, and utilize water resources of the San Juan River and surrounding tributaries. The SJWCD shall have the obligation and authority to acquire land necessary for the pool basin or to facilitate a land exchange with the U.S. Forest Service or others, and to promote and develop additional Project stakeholders, take the lead on future conditional water right diligence proceedings, and provide day-to-day management and Project facilitation as needed. PAWSD, and CWCB are not committing to any future financial support for the Project. CWCB does acknowledge that some legal support on future diligence proceedings will be required.
6. If the Project is constructed, SJWCD's \$1M initial investment will remain as its vested interest in the Project.

Participating Entities

Pagosa Area Water & Sanitation District

The Pagosa Water and Sanitation District was originally formed in 1971 and reorganized as the Pagosa Area Water and Sanitation District in 1977. The District is a quasi-municipal corporation and a political subdivision of the State. The District serves about 75 percent of the population of Archuleta County with municipal and industrial water, and generates revenues from water use fees.

San Juan Water Conservancy District (SJWCD)

Nearly all the PAWSD is located within the SJWCD boundary. The SJWCD was formed in 1987 and encompasses approximately 100 square-miles of the 1,365 square-miles of Archuleta County. SJWCD service area includes approximately 95% of the current municipal and industrial water demand within the County. The purpose of the SJWCD is to conserve, maximize and utilize the water resources of the San Juan River and its tributaries. In addition, a primary function of the SJWCD is to address future water supply needs. SJWCD's annual revenues are approximately \$100,000.

Summary

CWCB staff's involvement in these discussions has been from the perspective of water supply and water storage for the basin as well as protecting its interests in the loan and grant. It is not CWCB staff's intent in these discussions to provide PAWSD and/or SJWCD any indications that it is promoting or advocating future development in the basin, but rather an attempt to provide sufficient financial flexibility to allow the Project to succeed on its own merit.

Recommendation

Staff recommends that the Board direct staff to proceed with negotiations with Pagosa Area Water and Sanitation District, to amend its existing loan contract with the Colorado Water Conservation Board, Contract C150261, per the terms and conditions listed as 1 through 6 above.

The terms and conditions identified above shall be in the form of a signed agreement, between the Pagosa Area Water and Sanitation Company, the San Juan Water Conservancy District, and the Colorado Water Conservation Board. The agreement must be executed prior to Loan Contract C150261 being amended.

San Juan Water Conservancy District
P.O. Box 4632
46 Eaton Drive; Suite #5
Pagosa Springs, CO 81147

Pagosa Area Water & Sanitation District
P.O. Box 4610
100 Lyn Avenue
Pagosa Springs, CO 81147

Letter Of Intent

The Pagosa Area Water & Sanitation District ("PAWSD") and the San Juan Water Conservancy District ("San Juan") enter into this Letter of Intent in order to structure discussions with the Colorado Water Conservation Board ("the CWCB") to finalize a satisfactory agreement that both relieves PAWSD of its financial obligations to the Dry Gulch Water Facility Project (the "Dry Gulch Project"), and acknowledges efforts by San Juan to develop the Dry Gulch Project on a more practicable basis with a broader group of interested partners.

By letter dated September 24, 2013, PAWSD gave San Juan notice of termination of the Amended and Restated Inter-Governmental Agreement ("IGA"), which defined their respective obligations concerning the Dry Gulch Project. The IGA was terminated on or about March 23, 2014. Significant issues surviving that termination include co-ownership of the 660-acre Running Iron Ranch ("the Ranch"), shared water rights directly and indirectly related to the Dry Gulch Project, and long-term debt obligations to the CWCB incurred in the purchase of the Ranch.

On February 17, 2014, the parties met to discuss possible solutions to the issues remaining following termination of the IGA. At that meeting a concept emerged that would allow San Juan to move the Dry Gulch Project forward, while allowing PAWSD to trade its equity in the Ranch for substantial debt reduction from the CWCB. PAWSD authorized the President of San Juan to represent its interests in discussions with the CWCB to develop this concept.

Working from this "debt-for-equity exchange" concept, a series of meetings were held which eventually resulted in a CWCB executive session in July 2014 which the Parties understand authorized CWCB staff to work toward an agreement with PAWSD and San Juan.

PAWSD and San Juan are the only parties (the "Parties") to this Letter of Intent. This Letter of Intent is subject to approval by each Party's respective board. The purpose of this Letter of Intent is to facilitate discussions between the Parties and the CWCB to resolve the issues associated with the Dry Gulch project. The terms and conditions of this Letter of Intent are as follows:

1. The Parties agree that an exchange of PAWSD equity in the Ranch to the CWCB for substantial debt relief is to both Parties' mutual advantage. Further, the Parties agree that if the principal outstanding on PAWSD's CWCB loan cannot be reduced by amount equal to the appraisal value of the Ranch, or \$4.6 Million, which ever is more, then PAWSD may seek other means to reduce its debt to the CWCB.
2. The Parties agree that, after the "debt-for-equity" exchange is executed, but prior to full payment of the remaining debt by PAWSD to the CWCB, fifty percent (50%) of all sales of Ranch property determined to be unnecessary for the Dry Gulch Project will be applied to the outstanding principal owed by PAWSD to the CWCB.
3. The Parties agree the "debt for equity" exchange shall include re-structuring of the remaining indebtedness owed by PAWSD to the CWCB. The Parties agree that reasonable terms for a re-structured CWCB loan will include a reduction of outstanding principal amount by no less than the appraisal value of the Ranch or \$4.6 Million, which ever is more; reduction of the annual interest rate ("APR") to no more than 1.75%; and a full term for payment of thirty (30) years – all other terms and conditions to remain essentially the same.
4. San Juan agrees, at its cost, to provide an appraisal to the CWCB establishing the fair market value of the Ranch; further, San Juan agrees to utilize its equity in the Ranch to support this debt-for-equity exchange. Finally, San Juan agrees to share the results of the appraisal with PAWSD.
5. The Parties agree it is in their mutual interest to protect the conditional water rights for the Dry Gulch Project, and pledge cooperation with each other to accomplish this goal. The Parties cooperation includes but is not limited to: (i) PAWSD agrees to make long-term planning commitments acknowledging the Dry Gulch Project and its attendant conditional water rights as an option; it being understood that such planning commitments do not obligate PAWSD to any future financial commitments to the Dry Gulch Project; (ii) PAWSD agrees to include the Dry Gulch Project in its planning documents as a principal storage option for future water demand growth which cannot be met by existing reservoirs; and (iii) PAWSD commits to an ongoing evaluation of future water purchases from the Dry Gulch Project based on long-term demand projections, evaluation of cost, viable alternative sources of water, and consideration of the prospective likelihood the Dry Gulch Project will actually be built and able to provide water to PAWSD.
6. Apart from the restructured debt owed by PAWSD to CWCB for the Dry Gulch Project, the Parties agree PAWSD is no longer obligated for any other or further expense or liability associated with the Dry Gulch Project. San Juan agrees to support inclusion of a provision in the PAWSD agreement with the CWCB stating

unequivocally that PAWSD has no responsibility to develop water storage or purchase any interest in the Dry Gulch Project.

The Parties agree to cooperate in implementing this Letter of Intent by having representatives from both boards meet regularly and agree further to promptly refer any points of disagreement to a mutually agreed third party for advice and/or counsel.

The Parties may amend or otherwise change the terms and conditions of this Letter of Intent by a writing signed and adopted by the respective Parties in the same manner and form as this Letter of Intent.

Either Party may terminate this Letter of Intent immediately upon written notice to the other Party.

Signed and dated this ____ day of September, 2014.

San Juan Water Conservancy District

Pagosa Area Water & Sanitation District

By: 

By: _____