

## Commentary

# WATER SUPPLY FOR “REO,” “NOD,” AND “DEFAULTED” PROPERTY

by John Musick

When you walk into a house you expect water when you turn on the tap. If no water comes out you may think that there is a plumbing problem. But what if the plumbing is fine and the problem is there is no water supply?

Can't happen, you say: "I have papers to prove that I have a guaranteed water supply, and besides it is raining."

### **“WET” WATER VS. “PAPER” WATER:**

What you have is conflict between “**wet**” water supply (surface rain, snow and groundwater collected and delivered to developments by a “**water purveyor**”) vs. “**paper**” water supply (“**will serve letters**” for water supply). Every loan portfolio with **REO**, **NOD** and **DEFAULTED** property has some form of “**wet**” water supply and “**paper**” water supply.

### **VERIFY TITLE, TAXES, INSURANCE, FEES, ZONING, ENTITLEMENTS—AND WATER SUPPLY**

Before taking back or buying any property, “**wet**” and “**paper**” water supply should be investigated just as you investigate title, taxes, insurance, fees, zoning and entitlement.

### **DO YOU HAVE A “WET” WATER SUPPLY PROBLEM?**

- **“California is headed toward one of the worst water crises in its history.”** (Governor Schwarzenegger)
- **“We may be at the start of the worst California drought in modern history.”** (Water director Les Snow)
- **“I don’t think the American public has gripped in its gut what could happen. We’re looking at a scenario where there’s not more agriculture in California. I don’t actually see how they can keep their cities going either.”** (Capitol Weekly-2/5/09, President Obama’s energy secretary, Californian Steven Chu)
- **““Scary,” “grim,” “conservation mandates.” It’s pretty scary. The public needs to tighten their belts. You have to rearrange all the molecules in your brain to think about using water differently.”** (Tim Quinn, executive director, Association of California Water Agencies)
- **“What’s eye-popping to me is these job losses [from less water].”** (Sacramento Bee-2/2/09)
- **“But the diametrically hostile philosophical and economic positions of myriad water stakeholders make it virtually impossible for political officeholders and/or voters to settle on a practical scheme to meet that need.”** (Sacramento Bee-2/8/09)
- **“We Californians, basking in sunshine, are having an equally disastrous winter. It’s the third dry winter in a row, notwithstanding a little recent precipitation, and the specter of severe water shortages is hanging over the state, compounding its severe economic woes.”** (San Jose Mercury News-2/7/09)

Yes the “**wet**” water problem is real and it is here (as you read this) and it is going to get much worse. The “**wet**” water problem can be both an actual “**wet**” water shortage and a budget shortage by the “**water purveyor**.” The “**wet**” water problem has the potential to reduce the value of your **REO**, **NOD** and **DEFAULTED** inventory, and also the quality of your existing loan portfolio and the quality of future loans. Unless, of course, the issue is resolved.

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### **“PAPER” WATER SUPPLY GUARANTEE:**

The following “**paper**” water supply documents may be your protection when “**wet**” water disappears or the “**water purveyor**” has a drastic budget shortfall:

1. The “**water service agreement**,” “**will serve letter**” or “**Water Supply Assessment**” issued by the “**water purveyor**” in conformity with the “**Urban Water Management Plan Act.**”
2. The “**wet**” water agreements by the **DWR, SWP, MWD, LA DWP** or ground water basin “**Water Master.**”
3. The “**entitlements**” such as the “**Development Agreement**” sets forth the status of “**wet**” water supply.
4. The municipal codes; “**water purveyor**” rules and regulations, case and statutory law will outline the obligations of “**water purveyors**” during times of water shortage and budget crisis.

### **WHAT ARE SOME EXAMPLES OF PROBLEMS YOU MAY BE EXPERIENCING IN THE VERY NEAR FUTURE?**

1. Declining water supply and declining budgets will control “**wet**” water supply to existing developments.
2. Dramatically increased costs of the minimum water bill which has to be paid for **REO**.
3. Insufficient “**wet**” water or money will force tough decisions between people in houses desperately requiring water vs. continuing water availability to vacant buildings and entitled lots.
4. Some isolated areas already have occupied homes and businesses vacated and loans defaulted due to water disruption or budget shortfalls for maintenance and supply.
5. The holding period, holding costs and transactions costs for **REO** or **NOD** could increase precipitously as the water supply crisis coupled with municipal budget crisis deepens over time.
6. Selling developer defaults on “**paper**” water agreements, simple water supply shortages due to drought, “**water adjudication**”, or “**water purveyor**” financial default due to the economy can leave homeowners and improved lot owners “high and dry”; and looking for a deep pocket to find financial relief.
7. “**Foreclosure**” or “**deed in lieu of foreclosure**” may not be sufficient protection for the asset manager to be insulated from the litigation costs or liability from a jury award from no “**wet**” or “**paper**” water rights.
8. The water crisis may be so severe that the unthinkable occurs: “**walk away**” from the asset rather than chase the asset with more money to cure water supply defects during a drought and budget crisis.

These extreme examples can be avoided by careful “**clear eyed**” review of all documents and relevant facts. Frequently the “**water purveyor**” or original developer is merely attempting to shift liability to the **REO** or **NOD** asset manager believing that they will not invest the time or money to call the bluff.

### **WHERE CAN THE ASSET MANAGER LOOK FOR ADDITIONAL INFORMATION AND PROTECTION?**

1. The original developer may have “**subdivision improvement bonds**” or other forms of “**guarantee**” for “**wet**” water supply to the development.
2. Annual review of all “**paper**” and “**wet**” water supply documents for **REO** and **NOD** is essential to see if the agreements automatically adjust to adverse budget and “**wet**” water supply condition.
3. For “**paper lots**” or “**finished lots**” review “**will serve letters**” to insure that they are still in effect.
4. Accurately project the costs and reserve cash for the management of the real estate portfolio during the “**holding period.**”

Finally, be pragmatic about holding portfolios of problematic real estate assets or taking back title to those assets as that could lead to unexpected liability or curative expenses. Cautious optimism should be the watch word as there is a careful pathway out of the “**wet water**” vs. “**paper water**” dilemma discussed herein. It will take careful reading of many documents, internet research and counsel.

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