

Commentary

Why Think About Water Rights When Considering the “NOD”?

by John Musick

Real estate loans are frequently secured with title to the land and water rights. The land value can go up and down over time. Water right values generally continue to go up over time. Thus, water rights are too valuable to ignore as a part of your loan security.

Real estate loans are protected by a security interest in land which can give the right to foreclosure on that land. The security interest frequently also includes water rights. Before issuing the “NOD” the bank officer should be sure to also investigate the water rights which may be a part of the security for the loan. Then be sure to have the “NOD” cover the water rights.

The first water rights issues to consider are: What are the water sources around the land subject to the “NOD” such as aquifers, streams, springs or government water project canals? The other water rights issues are: Is there a water permit or adjudication or contract related to the water rights? Another water rights issue is: Are there any water wells, ditches, dams or spring boxes on the land showing existing or past use of the water rights on the land? The final water rights issue is: Where is the market to lease, sell, trade or move the water rights and what is the value of the water rights?

As a part of assessing the market for the water rights and the water rights value, be sure to consider that the land may have uses for such other things as solar electric generation. Most solar generation requires some water, and some solar generation requires a lot of valuable water rights. Also remember that California adopted the water supply law called the Urban Water Management Plan Act (“UWPA”) and Water Supply Assessment (“WSA”). Water agencies are required to issue a revised WSA and UMPA every 5 years certifying a reliable water supply. That process frequently requires water agencies to buy water rights at very high values.

With land values down and development approvals worth little and infrastructure worth less than cost, lenders should look to water rights to sell as the only remaining thing of tangible immediate value covered in the “NOD.” How much can the water rights be worth? In many instances the water rights can be worth significantly more than the value the land held at its peak value.

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