

From: [Steve Thomas](#)
To: ["Conrad McCarthy"](#)
Cc: ["David Blouin"](#); ["Russell Palmer"](#)
Subject: Water system expenses
Date: Wednesday, August 12, 2015 9:08:34 AM

Conrad:

Please see my answers to your latest questions in red below. I hope that you get this in time for your meeting.

Steve

From: Conrad McCarthy
Sent: Tuesday, August 11, 2015 11:24 AM
To: Steve Thomas
Cc: David Blouin; Russell Palmer
Subject: RE: Water system expenses
Importance: High

Steve,

Thank you for the clarification. I applaud the work that David and the extended board have been doing on the transfer of water service to Liberty, and are looking forward to the completion. As many have noted, having a 100-year assured water supply will increase the value of all properties on the ranch. I would appreciate clarification of a few points in your reply.

Allocation Method

You state that allocation by metered lot is the only option available under the CC&Rs. Assuming that all of the allocation is directed at payment of water system operating expenses (on which I have other questions), my reading of article 17.8 in the first amendment to the CC&Rs is that the allocation is a choice for the Board.

“All water system operating expenses shall be deemed to be Common Expenses to be paid from the Regular Assessments. Alternatively, upon a vote of two-thirds of the members of the Board, such expenses **may be apportioned among only those Owners connected to the water system in one of the following two ways: (i) on the basis of the amount of water used (as determined by meter); or (ii) on the basis of the number of Lots owned.”**

The first sentence says that the default is that these expense are Common by default; the second gives the Board the *option* of using some metric related to meters, but does not mandate it. **Until last year, the regular assessments were more than enough to cover all expenses related to the water system, but that changed due largely to the amount of water that had to be purchased and in part due to expenses related to Liberty. When the Board realized that even the surplus from prior years wasn't going to be enough in 2014, it made the decision that it was time to pass the operating expenses through to those using the water. The cost of their “free” water has been subsidized by the amounts paid by other lot owners in the past.**

In addition, if the Association cannot charge on a usage basis, why does option (i) above seem to allow it? Or does “as determined by meter” refer to allocating based on the total metered consumption to date, similar to the text in article 17.9? Is this total metered consumption method also not allowed for the Association? **It does allow the charges to be based on meter readings, which I thought was permissible when I wrote it in 1997. However, we have subsequently consulted a water law expert, who says that any charges based on usage, regardless of what you call it, can only be collected by a regulated utility with filed rates.**

Amount and Nature of the Assessment

As you gathered from my note, and many of the other emails, \$66,000 seems like a lot of money for just water system operation. It certainly isn't just the fee for the bulk water. Your argument seems to be that anything done to provide water to the ranch is an operating expense. My reading of 17.8 is that operating expenses cover costs to **“operate, maintain, repair or provide ordinary replacements to the water system”**. Doing the work for acceptance by Liberty falls more under the Capital Expenses described in 17.9. The developer and Board have made the decision (rightly) to pursue Liberty, rather than repairing/redrilling the failed ranch wells. If Liberty was not an option, we would be (to quote 17.9) **“deepening or improving any wells included in the water system and to drill any new wells determined to be necessary for its continued operation; (b) all costs to extend the water system to any Lot not then served; and (c) all other capital repairs, maintenance or replacement of water system improvements”**. In other words, Capital Expenses.

I think this is a question of interpretation, and choice. Given the very substantial investment the developer has made in infrastructure, I don't think anyone would dismiss their contribution. However, I believe that many of the non-resident owners would have no problem calling the Liberty acceptance costs an infrastructure improvement and paying their share via Capital Improvement or Reconstruction Assessment. **I agree that it is a question of interpretation, and the non-resident owners really should bear their share of the costs related to Liberty. And as long as we are covering the capital expenditures with the regular assessments, they are in fact paying their share, without the need for a separate Capital Improvement or Reconstruction Assessment. However, they should not have to continue to subsidize the expenses of providing water that they are not using. And note that if we did a separate capital assessment, lots owned by the developer and its affiliates would be exempt pursuant to the CC&Rs, but instead it is paying for the four meters it uses (for only three lots), thereby paying \$12,000 or just over 18% of the total itself.**

You make a good point that the total water-related expenses in the budget exceed the \$66,000. I've chosen to not to stir up more noise around project management fees, as I don't want David to waste his time doing time-writing in the interest of transparency. However, at the Annual Meeting, we did note that only \$53,000 (45+4+4) was identified as water related in the 2015 Budget. The other \$13,000 was general budget shortfall, which should not be allocated by meter. This amounts to a \$600 difference (small, but not insubstantial). **You know that David is a straight-shooter, so when he says that about half his time is spent dealing with maintaining the water system, you know it's true. (And as someone who has had to keep track of my time by the tenth of an hour for 39 years, I would never even ask David to try to keep detailed records; that would be the last straw.) So if you add \$26,000 to the total you got, you come out well over \$66,000. You should also add in the**

\$5000 line item for Engineering & Consultants since that's for normal operations, not Liberty, and some of the \$3,500 line item for Utilities-Common Area which is attributable to running the well pumps to put water into the system. And since the budget shortfall from 2014 was due to water system expenses, it would also be appropriate to add that, but it's not necessary to get to the total.

I appreciate the work that has gone into this issue, and apologize for not getting the draft minutes up sooner. Much of the angst amongst the residents has been that the water issue has been submerged since February, and the assessment "comes out of the blue" while they are off ranch. However, I think the main concern is around the fairness of allocation. **We probably should have given more advance notice that it was coming, but I think we have been very fair in the allocation.**

I would appreciate your comments and clarification on my questions above, hopefully in time for me to help clarify the issue at tomorrow's meeting.

Kind regards,
Conrad

From: Steve Thomas
Sent: Tuesday, August 11, 2015 10:13 AM
To: 'Conrad McCarthy' 'David Blouin'
Cc: 'Russell Palmer'
Subject: Water system expenses

Conrad:

Let me answer the specific questions you asked in the email you sent to David and copied me on last week, and then I'll add some more general comments.

I thought David and I made it clear at the annual meeting that the Board had decided that there would be an assessment for the water system. We thought we knew the total would be the \$66,000 shortfall projected in the 2015 budget, but we wanted to make sure that was neither too high nor too low before actually sending bills. As for the method of allocating the shortfall, this is the only option available under the CC&Rs. The Association, as a domestic water user provider, is not allowed to charge on a usage basis. That would require a full-blown creation of a regulated, public utility, like Liberty, which we have no desire to do. The meters were only installed at Liberty's request as part of the annexation process.

As to water usage by cattle, David can't say with any degree of accuracy how much comes from the water system. The cattle get their water from wells a third of the year, mostly from rainfall another third, and the two meters that provide much of their water the remainder of the year also supply a house and the stables, so it is impossible to determine how much of it they are drinking. In his opinion, the amount of purchased water they use is insignificant compared to the total. That's also true for the recent breach you mentioned. David estimates that the cost of the water lost was in the \$100 to \$150 range.

Therefore, the budget shortfall is fully allocable to the expenses of operating the water system, as itemized in the budget. There are some expenses related to getting the system into Liberty's service area, but given the fact that the wells simply are not providing what the

people connected to the system are using, these expenses can also be viewed as “operating” in nature because, if this acquisition doesn’t go through, there may not be a water system for long. And since David spends about half his time dealing with the water system, adding half of what he is paid to the total brings the expenses well above \$66,000, even if you don’t want to consider these other expenses.

Now for the general comments, which are in response to some statements made and questions raised by other owners in recent emails that David was copied on.

First, it should be noted that the developer voluntarily at its sole expense designed, engineered, and built approximately seven miles of underground water pipelines along with the infrastructure to provide a consistent and reliable source of water to Morning Star Ranch. Just the cost of purchasing a lot outside the Ranch, running a water line from there to get the water to the reservoir, and building a pumping station, which was given to Liberty without charge, was about a quarter million dollars. And that was necessary just for the bulk purchases that have kept the water system going for several years now. Lot owners have been using water since 1998, but in all that time there has never been an assessment for the water system until now, and no portion of the regular assessments has ever been used to build the infrastructure.

Why are all lot owners not asked to share in this current assessment? Simply put, because they are not using water. That’s also what the CC&Rs provide. When and if other lot owners build a house they will be expected to participate.

Furthermore, please be advised that the Board has determined that individual owner participation in the water distribution system is voluntary. Any owner who does not wish to participate may elect by written notice not to do so. In that event, they have the right to secure an alternative source of water and not pay the current or future water assessments. For clarification as to the Association’s obligation to lot owners concerning the provision of water and the lot owners’ alternatives, I refer you to the First Amendment to the CC&Rs, which you have posted on the website.

As to the matter of MSR’s transparency, each year our CPA firm provides copies of the MSR Federal tax return, AZ state tax return, actual and pro forma budgets for the prior calendar year, the current year’s budget, and an account balances report. At this year’s annual meeting, it was suggested that in the future these documents could be circulated in advance of the meeting (presumably with the meeting notice), so owners could submit questions which David or I could then be prepared to answer at the meeting. The Board has agreed to implement this suggestion.

I hope that I have answered everyone’s questions and adequately addressed their concerns, but please let me know if you need something more.

Steve

From: Conrad McCarthy
Sent: Thursday, August 06, 2015 11:30 AM
To: David Blouin
Cc: Russell Palmer; Steve Thomas
Subject: Water system expenses

Dave,

I got the supplemental assessment for water yesterday... no surprise that one was needed. However, at the annual meeting it appeared to me that a final decision of how to allocate the costs had not been made, although the draft minutes later issued by Steve implied that that it had, and your note says that the Board has confirmed that the costs will be allocated to metered lots.

I have a couple questions related to the allocation:

- At the annual meeting, Roy Farrell asked what portion of the annual water cost/consumption went to cattle. Is this known or knowable?
- I'm assuming that breaches of the ranch water infrastructure, such as what happened on Alamo recently, are unmetered. Is this correct?

Both questions get to the basis of the board decision to allocate the water cost to only to connected water meters.

- If water used in cattle operations is significant, then all property owners are receiving benefit via the tax relief, and thus might be expected to share the cost.
- If water "wasted" on infrastructure breaches is significant, again all property owners who do, or will, benefit from the infrastructure might be expected to share in the expense of the maintenance and operation. (Yes, repairs are in the budget for \$4000, but the cost incurred from leaks is probably lumped into the \$45,000.)

My own expectation is that both categories of water consumption are probably small, hence gross allocation to metered lots is a practical approach given that we are not actually reading the meters. However, the \$3000 assessment amounts to 625% of my annual water cost based on my metered consumption and current Liberty water rates. For that kind of uplift, I'd like to at least understand what I'm subsidizing.

I think that you will have an easier "sell" if you had measurements, or justifiable estimates, to show that these categories are indeed in the noise, at that it is fair to make the allocation across metered properties.

Please let me know your thoughts. I'll combine these with a posting of the announcement and the draft annual minutes to the website.

Kind regards,

Conrad