



## COUNCIL DECISION REQUEST

SUBJECT: Tower Well Water Credits

MEETING DATE: 3-5-15

SUBMITTED BY: LaRon G. Garrett, Asst. Town Mgr 

SUBMITTAL TO AGENDA  
APPROVED BY TOWN MANAGER

AMOUNT BUDGETED:

EXPENDITURE REQUIRED:

  
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EXHIBITS (If Applicable, To Be Attached): Letter From Developer, Report Concerning Tower Well Water Credits

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### POSSIBLE MOTION

I move to leave the expiration date for the Tower Well Water Credits at April 17, 2015.

OR

I move to extend the expiration date for the Tower Well Water Credits to (insert desired date).

OR

I move to direct staff to negotiate a purchase of the Tower Well Water Credits from the current owners.

OR

A combination of the above motions.

### SUMMARY OF THE BASIS FOR POSSIBLE MOTION:

Prior to January 14, 2007, subdivisions in Payson that contained more than 20 lots or units were required to provide a 'new' water supply for their development. A 'new' water supply was considered a water source that was not previously connected to, or available to, the existing Town of Payson water system. Earlier developers and the Town of Payson had already tapped the available water inside the Payson corporate limits by the early 2000's. In 2005 the Town entered into an agreement with a private entity, Terra-Star Valley-40 LLC, that allowed them to construct a well in what is now the Town of Star Valley and connect it to the existing Payson water system. This well produced more water than the developer needed and the agreement also allowed him to sell his excess water to other developers. This well is known as the Tower Well and the water produced from this well and sold to the private developers is known as the Tower Well Water Credits. These credits could then be surrendered to the Town to meet their 'new' water supply requirements for a new development. One Tower Well Credit would be equal to providing water for one residential unit. See the attached report for a more in-depth discussion of this subject.

During 2005 and 2006 one thousand Tower Well Water Credits were sold. They were purchased by seventeen different entities. The original agreement with Terra-Star Valley-40 limited the life of the Tower Well Credits to 5 years from the date of that agreement. That expiration date was April 17, 2005. Of the one thousand credits sold a total of 148 have been surrendered to the Town of Payson. That leaves 852 credits outstanding at a value of \$4,628,200.

Town staff has received a request from Michael and Cheryl Schlotman, developers of the Rim Ridge Estates Subdivision, to either extend the expiration date or purchase their Tower Well Water Credits (See

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## ***COUNCIL DECISION REQUEST***

attached letter). The Schlotman's were developing the property at the northwest corner of Highway 260 and Mud Springs Road. Their original plan of development was submitted to the Development Services Committee in July, 2006 proposing 102 condominium and townhouse units. Per their application they intended to purchase the first required 20 water units from the Town and purchase the remaining from Terra-Star Valley-40 LLC. That project was later revised and resubmitted to the Development Services Committee in November, 2006 proposing 74 Townhome patio homes. This application also indicated the use of Tower Well Water credits to provide water for the project. The Schlotman's purchased 40 Tower Well Water Credits from Terra-Star Valley-40 LLC in 2006 to provide water for this project known as Rim Ridge Estates. They, like the other developers, purchased a sufficient quantity of the Tower Well Water Credits to ensure that they would be able to construct their project with the desired number of lots. Under the town requirements at that time there was no other feasible option for them to provide water for their projects. The purchase of these credits was a prudent business decision based on the requirements at that time. The preliminary plat was ultimately approved by the Town Council in October, 2007. The approved plat showed 54 attached townhouse lots. The construction of the project was phased and the final plat for the first phase was approved by the Town Council in July, 2008. This first phase included 14 lots for attached townhomes. One triplex has been constructed using 3 of the available 40 Tower Credits the Schlotman's purchased.

In December, 2006 the Payson Town Council repealed the requirement that subdivisions exceeding 20 lots had to provide their own water effective January 14, 2007. At that same time they also extended the expiration date of the Tower Well Credits from April 17, 2010 to April 17, 2015. The value during the extended period was reduced to whatever the developer had paid for the credit, rather than equal to the value of one residential unit of water. This gave the owners an additional 5 years to use the water credits. Due to the sluggish economy only 148 of the credits have been used.

All Tower Well Water Credits were purchased from Terra-Star Valley-40 LLC, not from the Town of Payson. The Town has not received any funds from these purchases. For the Town of Payson to now purchase these credits from the developers would create an enormous financial hardship. First, there are no funds currently budgeted to make such a multi-million dollar purchase. Second, there is no value in the Town purchasing the credits. Under today's circumstances the town is able to provide water to all developments pending the completion of the CC Cragin Water project. Any funds budgeted to purchase these credits would reduce funds available to complete the CC Cragin Water project.

Extending the life of the Tower Well Credits will also create a financial burden on the Town and on the residents. An extension will reduce the funding currently anticipated to help fund the CC Cragin Water project.

In October, 2014 the Payson Town Council approved a water rate structure that included rate increases to pay for the CC Cragin Water project. Those adopted rates assumed that the Tower Well Credits would expire on April 17, 2015 and that all further water would be purchased from the Town. No additional expenses for dealing with the Tower Water Credits was anticipated. If the Tower Well Credits expiration date is extended or the Town purchases the credits, it will create a funding shortage for the CC Cragin water project and the water rate structure will need to be revised and increased again to accommodate this decrease in funding to the water department.



## COUNCIL DECISION REQUEST

This decision will not only affect the 37 outstanding Tower Well Water Credits owned by the Schlotman's, but will include all 852 outstanding credits.

The Council has the following options: (1) Allow the Tower Well Water Credits expire on April 17, 2015 as originally approved by the Town Council in 2006; (2) Extend the expiration date of the credits to a future date beyond April 17, 2015; (3) Purchase the outstanding 852 credits at a negotiated price; or (4) some combination of the above.

**PROS:**

**CONS:** Approving an extension of the expiration date or purchasing the credits will result in a financial burden that will need to be covered by again increasing the water rates.

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**FUNDING:**

Acct:	Budget:	Available:	Expense:	Remaining:
Acct:	Budget:	Available:	Expense:	Remaining:
Acct:	Budget:	Available:	Expense:	Remaining:

FM: \_\_\_\_\_

Date: \_\_\_\_\_

February 18, 2015

Town of Payson  
303 N. Beeline Highway  
Payson, AZ 85541  
Attn: LaRon Garrett

SUBJECT: Counsel Meeting Request  
Rim Ridge Estates/Schlotman  
WATER CREDITS EXPIRATION 4/17/2015

We would like an opportunity to discuss our situation with the water credit expiration in hopes to reinstall the credit value by an extension of time or offer purchase of our credits to the Town at a much discounted cost allowing additional profit for the Town with the resell of our credits. We believe our circumstance is different than others which could allow the Town to do this without same obligation to others.

Thank you very much.

Best regards,

Michael and Cheryl Schlotman  
928 970 1056

## **TOWER WELL WATER CREDITS**

### **February, 2015**

#### Background

The Town of Payson was incorporated in 1973. In August, 1980 the Town purchased the water system serving the incorporated area from United Utilities, a private water provider. At that time the Town established regulations regarding water supply for new developments. Essentially, the Town required that all new developments provide the Town with a water supply adequate to provide for the development.

In 1982 the requirements were modified to allow the Town to require the payment of a fee, at the Town's discretion, in lieu of providing a water supply for a new development. At that time the fee was \$500 per lot or unit. This criteria continued until 1996.

In October of 1996 the Town adopted two ordinances that pertained to water. Ordinance No. 480 imposed a Water Development Impact Fee of \$1,503 per unit. Ordinance No. 481 required all subdivisions of 20 lots or more to provide an adequate water supply for the development and addressed when the fees for the smaller subdivisions were paid. This became known as the 20 lot rule. During the time period between 1996 and 2006 many developments with no more than 20 lots were created. They were allowed to pay the current Water Development Impact Fees rather than provide water. There were also some larger developments where the developer provided a new water supply.

A complete time line of water department events is included in Appendix 'A',

#### Tower Well Credits

Over time, it became more and more difficult to find 'new' water for a larger development. New water is defined as a water supply that was not previously connected to or available to the existing Town of Payson system. The entire area within the Payson corporate limits had been explored and all available supplies were connected to town's system. The Town had begun looking outside the corporate limits for water. Exploratory wells had been drilled on private property in the Rye Creek area south of Payson, at the Summit Mine northwest of Payson and at the Doll Baby Ranch west of Payson. The Town also drilled exploratory wells on United States Forest Service land immediately northeast of Payson and west of Payson in the area of Snow Storm Mountain. While a lot of information was gathered concerning the local geology, all these efforts were unsuccessful in finding a new water supply for Payson. The Town of Payson had also been investigating the possibility of getting water from the Blue Ridge Reservoir (now called C. C. Cragin Reservoir) since the 1970's. In December, 2004 the United States Congress passed the Arizona Water Settlements Act which created the possibility of C. C. Cragin Reservoir (then called Blue Ridge Reservoir) being used in Payson. With this act, the ownership of the reservoir, dam and pumping system was transferred to the U. S. Bureau of Reclamation with Salt River Project (SRP) as the operator. All water rights in the reservoir were transferred to SRP with the possibility of 3,000 acre feet being made available to Payson with an additional 500 acre feet available to northern Gila County.

In 2005 a development company, Terra-Star Valley-40, LLC approached the Town of Payson with the idea that they would provide a 'new' water supply to the Town for a development being constructed by Terra-Payson-40, LLC within the Payson Town Limits. They would construct these new wells and dedicate them to the Town. From testing it was determined that these wells could provide 400 gallons per minute of water at safe yield which is more water than was needed by their subdivision. The wells were located in an unincorporated area of Gila County east of Payson and north of Highway 260. They were known as the Skyrun wells. In April, 2005 the Town entered into an agreement with Terra-Star Valley-40 and Terra-Payson-40 for them to construct the wells, connect the wells to the Town's water system, and dedicate the wells to the Town. In return, Payson-Star Valley-40 was allowed to sell the excess water to other developers for additional development and the Town would accept these credits in lieu of the current Water Development Impact Fee. The amount of 1,000 water credits was established for the 400 gallon per minute flow from these wells. The agreement states that these credits were to expire 5 years after the effective date of the agreement. That put the expiration date at April 17, 2010. The agreement also states that the Town of Payson would accept these water credits in lieu of requiring a developer to provide new water to the Payson water system. After further investigation it was determined that access to run a water line between these wells and the Highway 260 right of way was not easily obtainable. The idea to use these wells as a Payson water supply was abandoned. However, these wells were later dedicated to the Town of Payson but were never connected to the Town's water system. The Town of Star Valley eventually purchased these wells from the Town of Payson.

In August, 2005 the Payson Town Council entered two additional water agreements. The first was an agreement with Terra-Payson-40 and Payson-Star Valley-40 to amend the original agreement with the same entities to use a different well for the water supply. Essentially, all other terms of the agreement remained the same. The new well was known as RH-2 and was owned by R&H Boulder and Granite, LLC. The new well had a tested production capacity of 530 gallons per minute. Terra-Payson-40 and Payson-Star Valley-40 entered an agreement with R&H Boulder and Granite, LLC for this well to be dedicated to the Town of Payson. The second agreement was between the Town of Payson and R&H Boulder and Granite, LLC. This agreement was that the Town would pay R&H Boulder and Granite, LLC \$750,000 for the extra 130 gallon per minute capacity of the RH-2 well when it was dedicated to the Town. This left 400 gallons per minute of flow, or 1,000 water credits, available for Payson-Star Valley-40 to sell to private developers desiring to develop property within the Payson town limits exceeding 20 units without having to provide new water.

The RH-2 well is located south of Highway 260 and just east of the Ford dealership in the community of Star Valley. There is a communications tower adjacent to the well site. Due to the adjacent communications tower, this well has become known as the Tower Well. The water credits sold to private developers for future development in Payson have become known as the Tower Well Credits.

Subsequent to the construction of these wells the area east of Payson along Highway incorporated as the Town of Star Valley on November 1, 2005. Both the Skyrun wells and the RH-2, or Tower, well are now located within the Town of Star Valley corporate limits.

Terra-Star Valley-40 began selling the excess Tower Well Water Credits to other developers for use within the Town of Payson. The Tower Well Credits could then be transferred to the Town of Payson in lieu of having to provide new water for a development. One thousand water credits were available for sale. The purchaser's of the water credits is shown in Table 1. A total of 18 entities received water credits from the Tower Well. The price paid for each credit varied from \$4,000 to \$5,950 per credit.

At the time the Tower Well Credits were on the market they were the only viable avenue for developing property in Payson in excess of 20 lots. The local developers were very eager to buy these credits to ensure there would be water available for their developments in the future. The credits were purchased with private agreements between the individual developers and the Payson-Star Valley-40 LLC. All purchasers of the Tower Well Credits were made well aware of the fact that these credits expired on April 17, 2010 per the original agreement between the Town and Payson-Star Valley-40. The Town of Payson was not a party to these agreements and did not receive any funds paid for those credits. All funds paid for the Tower Well Credits were paid to Payson-Star Valley-40 LLC.

Table 1  
Tower Well Water Credits Sold and Used

Purchasing Entity	Total Credits Purchased	Total Credits Used	Remaining Credits
Bison Cove LLC (now Seven Mile Max LLC)	245	11	234
Terra Payson 65 LLC (Forest Edge Sub.)	31	5	26
Center Ridge Apartments LLLP	32	32	0
Habitat for Humanity-Contributed	24	0	24
Ponderosa Heights LLC	140	0	140
Jeff Vaughn Homes, LLC (East Gateway 2)	6	4	6
K.D.S. Construction	47	0	47
Hulburt Development, Inc. (Chilson Ranch	40	0	40
Manzanita Hills Six LLC	13	5	8
DiBella Family, LLP	60	0	60
Forest Edge LLC	14	0	14
Falcon Lookout LLC	22	1	21
Cheryl Schlotman	40	3	37
Mark Voss	12	0	12
EJD West Development	104	0	104
Workforce Housing Coalition, LLC	63	0	63
Workforce Housing Coalition, LLC	20	0	20
Town of Payson	87	87	0
Total	1,000	148	852

The final remaining Tower Well Credits were purchased by the Town of Payson in December, 2006. At that time the Town of Payson was negotiating with the SRP to receive 3,000 acre feet of surface water from CC Cragin Reservoir so the Payson Town Council removed the 20 lot/unit limit from developments. They also prohibited the establishment and/or sale of additional water credits. With the removal of the 20 lot/unit limit the town would now sell water to any developer

for the established rate for each Equivalent Residential Unit (ERU). At that time the cost of each ERU was \$3,785. In June, 2007 the Town increased the cost of each ERU to \$7,570. In 2014 the Town decreased the cost of an ERU to \$6,592 due to changes in Arizona Revised Statutes that change the requirements for development impact fees.

The Town Council also approved Resolution No. 2226 in December, 2006. This resolution extended the life of the Tower Well Credits until April 17, 2015. The value of each credit was equal to the cost of the Water Development Fee from April 17, 2005 to April 17, 2020. The value of each credit was reduced with Resolution No. 2226 to be equal to the value the developer paid to Payson-Star Valley-40 LLC from April 18, 2010 to April 17, 2015. As of now, XXX of the Tower Well Credits have been surrendered to the Town of Payson in lieu of paying the current water development impact fee.

In 2005 and 2006 the purchase of Tower Well Credits by various developers from Payson-Star Valley-40 LLC was a prudent business decision. This would guarantee water would be available for their developments in the immediate future when Payson was not able to sell them water. Unfortunately the building economy collapsed before developers were able to use a lot of the credits. Even though the Town of Payson extended the life of the Tower Well Credits until April 17, 2015, only 148 have been used.

The Town has received a written request from one developer for the Town to either extend the time period for the Tower Water Credits are valid, or purchase the unused credits from the developers at a reduced rate. Either option will create an undue financial hardship on the Town and its residents. One developer did negotiate an extension for his Tower Well Credits until April 18, 2021. In return the developer constructed the public Malibu Drive between Easy Street and Manzanita Drive including the roundabout at the Manzanita Drive-Malibu Drive-Park Drive intersection at his expense. Here the Town received a benefit substantially equal to the liability it accepted by extending the value of the credits.

The value paid for the Tower Well Credits that have not yet been used and that will expire on April 17, 2015 is \$3,469,900. The value of the Credits that will expire on April 17, 2021 is \$1,158,300. The combined value is \$4,628,200. There is no funding available in the 2014-2015 budget to fund a purchase of these credits. Due to the sluggish economy it would not be prudent to try and include the purchase of these credits in a future town budget. The option of extending the life of the existing Tower Well Credits also creates a financial burden on the Town and its residents. In October, 2014 the Payson Town Council approved a water rate fee structure for the next five years to include the debt service for the upcoming CC Cragin water line and treatment plant expenses. That rate structure does not factor in purchasing or extending the life of the Tower Well Credits. If either of the above options is followed the water rates will need to be increased again to cover this cost. The remaining option is to allow the Tower Well Credits to expire on April 17, 2015 as originally anticipated when they were extended in December, 2006.

### Conclusion

It was difficult for developers in Payson between 1996 and 2006 to provide 'new' water for their development. The Tower Well Credits provided a new option that was readily accepted. When developers purchased the Tower Well Credits appeared to be a prudent business decision. They

purchased them knowing in advance that they would expire in April, 2010. The Town Council generously extended them an additional 5 years until April 17, 2015. An additional extension or purchase of the Tower Well Credits would create undue financial hardship on the Town and its citizens to the benefit of a few developers.

# **APPENDIX 'A'**

**PAYSON WATER DEPARTMENT  
TOWER WELL WATER CREDITS  
TIME LINE**

July-1980 The Town Council approved Ordinance No. 109 and Resolution No. 235 which created the rules and regulations of the newly created water department. These regulations required all new developments greater than 3 lots to provide a water supply adequate for the proposed development.

August-1980 The Town of Payson purchased and began operating the then existing water system from United Utilities and created the Payson Water Department.

November-1982 Resolution No. 323 was approved further defining the water supply requirements for developments larger than 3 lots. It also added a provision that the Town could require a developer to pay \$500 per lot or unit in lieu of providing a wet water supply.

May-1986 The Town Council passed Ordinance No. 275 modifying Resolution No. 235 and No. 323 pertaining to water supply. The Ordinance, along with other water department issues, eliminated the exemption for developments of less than 4 lots to bring water. It also added the requirement of paying a portion of the Water Development Fee at the time of platting and the remainder at the close of escrow on each lot, if a fee was required by the Town in lieu of providing water. The total fee was still \$500 per unit. This Ordinance also included a Town option to allow the developer to pay the fees over a 5 year period at 12% interest.

October-1996 Approved Ordinance No. 480 that imposed a Water Development Impact Fee (DIF) based on the burden imposed on the Town by new development. The fee at that time was set at \$1,503 per unit. The three components of the fee were established (technical studies, water storage, and water supply) with this ordinance. Also, the DIF was to be paid when the building permit was issued.

October-1996 Ordinance No. 481 was approved creating the 20 lot rule. Developments with 20 or less lots were required to pay the DIF established in Ordinance No. 480 rather than bring water. Developments larger than 20 lots still had to supply water. This ordinance also required that for developments of 20 or less, \$750 per unit was due at the time of platting with remainder due at the close of escrow. This ordinance also reduced the interest rate if the fees were paid over time from 12% to 2%.

November-1998 Ordinance No. 528 increased the Water Development Impact fee from \$1,503 per unit to \$3,785 per unit.

February-2001 Approved Ordinance No. 579 which increased the number of units that could be constructed without providing water in the Green Valley Infill Incentive District from 20 units to 60 units. This only applied if the project was considered an "affordable housing project". This was later repealed by Ordinance No. 696

December-2004 The United States Congress passes the Arizona Water Settlement Act of 2004 which opened the door for a potential water supply to Payson and other Northern Gila County communities.

April-2005 In conjunction with Resolution 2052, the Payson Town Council approved an agreement between the Town, Terra-Payson 40 LLC and Terra-Star Valley 40 LLC which allowed a developer to bring water into Payson from outside the Payson corporate limits. The agreement was to dedicate two wells to the Town that combined produced 400 gallons per minute. The developer could also sell up to 1,000 water credits to individual developers that the Town would accept as payment of the DIF. Section 9 of this agreement provided that the credits must be used within 5 years of the date of the agreement. The agreement was signed on April 18, 2005. (These wells were known as the Skyrun Wells and were never developed or put into production.) The developer was also to construct a 12" water line between the wells and the Town of Payson water system.

August-2005 Resolution 2098 was approved by the Council which changed the requirements of the wells that were to be developed in the original agreement approved by Resolution 2052. There would now be one well (the RH-2 Well commonly known as the Tower Well) that produced 530 gallons per minute. The Town would buy 130 gallons per minute capacity of the RH-2 Well and the developer would have rights to the remaining 400 gallons per minute. This 400 gpm equates to 1,000 water credits the well developer could sell to individual developers that the Town would accept as payment of the DIF. These 1,000 credits are what is now known as the Town Well Water Credits. The Town paid \$750,000 for the 130 gpm capacity in this well. The expiration date of the Town Well Credits remained the same at April 18, 2010.

April-2005 to December-2006 Private developers purchased Tower Well Water Credits from Terra-Star Valley 40 during this time frame.

November-2005 The area east of the Town of Payson and along Highway 260 was incorporated as the Town of Star Valley on November 1, 2005.

December-2005 The Town agreed with Resolution No. 2131 to operate the Tower Well under the Town's "Save Yield" policy; that the 130 gpm capacity that was purchased by the Town would be used to fill existing commitments and would not be considered 'new' water; and that the Skyrun Wells would only be used as monitoring wells.

May-2006 Resolution No. 2179 was approved accepting the Skyrun Wells, the Tower Well and all improvements and easements.

December-2006 Approval of Ordinance No. 696 and Resolution No. 2214 essentially removed the 20 unit limit on having to bring a water supply. It also prohibits the establishment of or sale of water credits.

December-2006 Resolution No. 2226 was approved that extended the live of the Tower Well Credits from April 18, 2010 to April 17, 2015. However, each credit is only worth the value paid for it when purchased after April 17, 2010, not the value of one ERU.

June-2007 The Payson Town Council adopted Ordinance No. 718A which increased the water development Impact Fee to \$7,570 for each Equivalent Peak Residential Unit. This was based on A.R.S. §§ 9-463.05 and 9-511.01.

August-2008 Resolution No. 2412 approved an agreement between the Town of Payson and Bison Cove, LLC. This agreement extended the life of the credits purchased by Bison Cove LLC to April 17, 2018 if the developer completed the construction of a portion E. Evergreen Street and a portion of N. Manzanita Drive by April 17, 2015.

April-2014 Resolution No. 2764 was approved amending the agreement approved with Resolution No. 2412. The amended agreement is to extend the Tower Well Credits owned by Seven Mile Max LLC (formerly Bison Cove LLC) until April 17, 2021. In return, Seven Mile Max was to construct Malibu Drive between Easy Street and Manzanita Drive, including traffic control improvements at the intersection of Malibu Drive and Manzanita Drive by December 31, 2014. The construction was completed and accepted by the Town in December, 2014. The amendment also converts their Tower Well Credits to water a development impact fee credit.

August-2014 Ordinance No. 848 was passed setting the current Water Development Impact Fee at \$6,592 based on the requirements of the amended A.R.S. §9-463.05.