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Valuing Water Rights in Eminent Domain: Nossaman

As water becomes scarcer in California, public agencies are looking for new sources and opportunities to provide water to their communities. When the government identifies those water sources but confronts unwilling sellers, eminent domain sometimes becomes necessary. This is currently taking place in the Antelope Valley, where the Rosamond Community Services District recently approved the adoption of a resolution of necessity to acquire water rights from agricultural land by eminent domain.

The District is facing shortages in its future water supplies and it is limited in the amount of groundwater it may use to serve its customers. The property identified is near an existing water distribution system, and the District could not locate another willing seller to secure sufficient water rights to meet the shortfall. It appears the owners plan to challenge the District's right to take the property, and if the District is successful, there will be a large fight on the value of the water rights. The District approved financing that would provide up to $17.5 million to acquire the water rights, which would be repaid through rates passed on to customers.

Valuation of water rights is a complex analysis that depends on a number of factors. In addition to determining the actual water rights in existence and their transferability, appraisers also consider:

- the quality of the water and its suitability for a variety of uses (agricultural, municipal, or drinking water);
- the costs to extract the water, including necessary improvements that must be installed to secure access;
- the reliability of the water source, including its priority in the water basin in the event of low-flow conditions; and
- alternative water supplies in the area, which dictates supply and demand and the price buyers and sellers will pay for water in the geographic vicinity.

Once those factors are established, appraisers typically use methodologies that are applied to traditional real estate valuation, such as the income approach, comparable sales approach, or cost approach. For example, in valuing water rights, an appraiser could consider the anticipated revenue stream of leasing the water, discounted to present value. Alternatively, an appraiser could look at other comparable transactions of water rights and make necessary adjustments to determine the appropriate value of the water rights. Or, under a cost approach, an appraiser could analyze the cost of developing an alternative water supply.

Rights that provide a reliable source of water, provide access to high-quality water, have minimal limits on transferability, and have scarce options for alternative water sources will ultimately fetch the highest price.

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