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Presidents Annual Review 2012

Dear Shareholders,

I hope this holiday season finds you well. The annual meeting of the company will be held on February 11, 2013 at the Redlands Mesa Grange Hall starting at 7 pm. Please mark your calendars and plan on attending the meeting if possible. If you are unable to attend, please make sure that a representative of your choosing has the proxy to vote your shares. A quorum of 50% of all voting shares is required to conduct business. Three of the 5 members of the board are up for re-election this year (Philip Ceriani, Bryan Klaseen and David Kuntz) . In addition to the annual business of the company, the agenda will include an important update of the proposed reservoir expansion project. The board will have representatives from our engineering and financial consulting staff available for brief presentations and questions.

Irrigation season 2012: The continuing drought conditions prevalent in the West for the last several years, returned again in 2012 with a light snow pack and unusually hot weather during the growing season. The reservoir did not fill this year for the first time since 2002. The last time prior to that was in 1992 which many old timers say was the worst drought year of the last 50 years. The drought in 2012 cut short irrigation water deliveries by a full month. Many growers were limited to a single cutting of hay or were subjected to vastly reduced yields from other crops.

Shareholders frequently ask about “stretching out” the water supplies in a short year, such as we experienced in 2012 by reducing flows. The length of our ditch (28 miles), combined with the elevation changes (10,000 feet at the reservoir to 6,000 feet on Redlands), and the rugged terrain encountered along the way create serious impediments to what can be done with flow management. In the early season, the upper ditch is frozen solid, and the company relies heavily on diversion rights from Leroux Creek and additional water supplies owned by many shareholders from “Project” water. As these assets begin to diminish, the lower elevations of the upper ditch in the Roatcap and Terror Creek basins begin to melt out and make up the supply difference. During this time our ditch mangers move heavy equipment into the area and plow out the road and “dig out” ice jams that exist in the ditch on the north facing exposures. This allows the company to capture all the melt water we are entitled to by our decrees. This process continues until the ditch is open all the way to the reservoir. Usually by early June the reservoir is full (6200 Acre Feet) and in most years spills a considerable amount of excess water into the Upper Cow Creek drainage. The decision to begin drawing the reservoir water is dependent on flow measurements at the lower end of the system. In 2012, our water rights fell out of priority very early on the Leroux Creek decrees. Despite extraordinary efforts by Doug Christner (operations manager), and Ray Penland to get things opened up on the upper ditch, there was simply inadequate snow pack to support a normal flow in the early season. It is interesting that the Overland irrigation season ended only 10 days ahead of the Fire Mountain Canal, (which has 3 times the storage capacity). I believe this is a great compliment to Doug and his staff for good management in 2012.

Once the company begins drawing reservoir water, the ditch works most efficiently at release flows of 52-58 cfs from the reservoir. Curtailing flows significantly below that amount can result in increased losses from evaporation and seepage losses along the path. Likewise, the distribution system on Redlands mesa does not work well below flows in the 35cfs range. At these lower rates, sprinkler systems do not work well, and gated pipe distribution barely keeps up with evaporation and absorption losses. Many of you experienced that this year. In the final analysis, water management is a difficult balancing act that is largely driven by the unpredictable realities of Mother Nature, over which we have little control. The company is adding some measurement strategies that may help us manage this process more precisely.

2012 Maintenance/Improvements: Overall the ditch is in excellent shape. Other than routine maintenance there were no disasters or structural problems this year. Our heavy equipment rentals were much less this year. We completed a number of infrastructure projects this year that were partially funded by grants obtained by the company from various agencies to include the Bureau of Reclamation, FEMA, and the State of Colorado.

Ditch Automation: In the fall of 2011, a remote sensing flow station was installed on the lower end of the upper ditch at Oak Mesa. After some calibration, the station worked well and provided reliable flow reading throughout the summer via a solar based satellite link accessible through the internet. This fall, another flow station was installed at the measuring flume below the reservoir. This was linked by a local radio network to a solar based satellite link located on the well housing of the reservoir. A sensing transducer was installed inside the well housing that will allow accurate measurement of reservoir height. This will allow monitoring of the "filling" of the reservoir during winter and spring months, as well as the rate of draw down. In addition, we are well into the engineering designs that will allow remote control of the discharge valves utilizing the same network. Depending on costs, the plan is to have this in place before the 2013 reservoir irrigation season. These efforts will reduce the manpower time it takes to get to the reservoir and manually adjust the valves and give more precise control of water delivery.

Emergency Action Plan: The State of Colorado requires that each year the reservoir undergo a rigorous inspection and issues a storage permit if there are no issues. A few years back, the State Engineer mandated that all high hazard dams complete an emergency action plan in the case of a dam breach. This is an extensive document including maps, emergency action notification, and procedures for integrating with the Delta County Emergency Department in the event of a catastrophic failure of the structure. We have been avoiding this for some years due to the enormous cost of completing the report. In a proactive effort, this year the company was able to secure a $10,000 FEMA grant to help with expenses. Your president, secretary and company engineer Bruce Marvin, toiled for many hours to get this project completed to the satisfaction of the State Engineer and the Delta County Emergency Supervisor. We are the first reservoir of our size to complete this project in the district. The breach failure maps are quite interesting and l urge you to look at the maps at the annual meeting**.**

Reservoir Maintenance: The trash gates protecting the inlet works were repositioned after winter ice lifted them from their moorings last year.(Never seen before) An 8 inch gate valve was repaired, with some difficulty, that was located at the very bottom of the 75 ft. Gate chamber. The air handling system to provide fresh air inside the structure was also rebuilt to ensure safety.

WEB site Upgrade: The company will be upgrading the WEB site to a more functional and useful interface that will be shared by the Overland, Redlands Mesa Water Users, and the Roberts-Stucker Ditch. Tom Howe was a great help in planning and writing the scoping

document. A local WEB developer has been chosen and we hope to have the upgraded site functional in mid 2013.

Reservoir Expansion

Proposed Project*:* The project is now entering its 8th year of permitting and planning since its first inception in 2005. The project would expand the Overland Reservoir by an additional 1010 AF feet of storage bringing the final capacity to 7173 AF. This would be accomplished by raising the height of the dam structure 5 feet using dirt from existing borrow pits from the 1987 expansion. Minor modifications would be made to the spillway and some added toe drainage to the auxiliary reservoir. The core structure of the reservoir was built in 1987 to store this full decree but because of budgetary constraints the structure was reduced in size. The storage decrees for the full amount of water are still in place and have been declared "absolute" by the water courts. Roughly 6200 AF of these storage rights are adjudicated prior to 1922 and are considered extremely valuable by Colorado River Water Authorities. In the event of a protracted drought cycle in the Colorado River Basin, these decrees are protected from being called away by Arizona, California and others that have rights to our upper basin water. From an engineering standpoint, this is an almost perfect expansion project because of its location, mature road access, perfected water rights and the robust existing infrastructure requiring little additional engineering. Depending on flows and snow conditions, the additional water would add about 10 days of water at normal flows. The protracted permitting delays and the uncertainty of the future regulatory requirements make cost estimates difficult. Construction costs in the $1500-$2000 per Acre Foot of storage are reasonable and place the cost between $1.5 and $2.0 million dollars. Although unknown today, I predict that significant "grant" money will be available in the future for planning and engineering will be available to preserve these historic storage rights.

To date, the company has spent $200,000 on permitting and engineering. About $75,000 of that has been grant money provided by the State of Colorado for wetlands analysis and yield determinations for the supply basin. We are planning to ask for additional funding in 2013.

Permitting: The reservoir resides on Federal Land (National Forest) and as a result, a portfolio of permits must be obtained to satisfy the regulatory requirements of numerous Federal and State agencies. The majority of the requirements relate to environmental issues. There is a complex patchwork of interconnected regulations surrounding Water Quality, Wetlands Protection, Fish and Wildlife Protection, Endangered Species Protection etc. Each of these agencies has a different agenda, culture and methodology for reporting and doing business. The regulatory burdens are particularly difficult for small companies such as ours that do not have unlimited resources. One wonders, given our experience, whether any project large or small can pass the regulatory hurdles in play in 2013.

The early environmental engineering studies concluded that the proposed expansion will flood 0.6 Acres of Fens Wetlands on the perimeter and impact another 6 acres of less important wetlands. Any impacted wetlands are considered "special" by the Environmental Protection Agency (EPA) and trigger the need for a special regulatory requirement known as a "404" permit. This is administered by the US Army Corps of Engineers (COE). For the past two years, the company has been working on this activity. Utilizing the expert help of Bruce Marvin (company engineer) Mike Klish (Environmental Engineer) and hundreds of hours of my volunteer time I can say that we are close to completing the required documentation. This has included preparing extensive written reports on the subjects of efficiency, alternative site proposal, purpose and need for the project, jurisdictional mapping, wetlands biologic analysis and a Fish Mitigation plan now mandated by the State of Colorado. The documentation is

largely complete and the company plans on moving forward in January with the actual permit application and the public notice offering. At this time, citizens, and specific interested government agencies will respond in written format outlining concerns. The COE will process this information and then decide to issue the permit or return the company to the drawing board for more work.

Once the COE 404 permit is issued (good for 5 years), the company then petitions the US Forest Service for a" special use permit". This requires another round of documents, including a NEPA (National Environmental Protection Act Assessment) and a number of activities specific to the US Forrest Service. There remain unanswered legal questions about how the USFS will handle the current "lease" agreement for a new project as well as issues regarding bypass flows and fish conservation pools.

Future direction

1) *Permitting:* Do we continue? For a small company, the sheer volume of document preparation, and preparatory work completed to date is extraordinary. All the elements of the 404 permit have been completed (from our perspective) which is not always the case with regulators. The company has a good sense of what we can and cannot do regarding regulatory demands. Ultimately, there is a question as to whether the EPA will simply veto the project, no matter what efforts or offerings the company may make to comply with the regulations. The USFS has other interests in their regulatory agenda that may require compromise and further study in the future. Our strategy at this time is to move forward and get through the public comment period with the "404" permit and get written responses to evaluate. If the comments suggest more cost or further scientific studies that cannot be funded with grant money, then most likely the project should be abandoned.
2) *Cost/Benefit:* What if we are successful getting permitted. Can we afford it? The proposed cost for an additional 10 days of water could add another $5-10 dollars a share to your annual cost. We are a mutual ditch company whose shareholders own their water rights. Ultimately you get to decide. My sense from listening to a lot of people talk about this topic over the past 5 years, is that as the demands water get increasingly difficult in the Colorado River Basin, any water stored that is protected by e pre -1921 water decrees, despite the cost will have extraordinary value. The question for our small agricultural company is how to release that value to the shareholders without putting undue financial hardship on an agricultural community that is already under stress. I believe there will be mechanisms forthcoming to release this value, (augmentation, lease arrangements, etc.) but at the present time it is unclear just what they will be. We have a loan secured with the CWCB at low interest rates which is in effect. But the facts remains, if we do this project, your cost for water will most likely go significantly up.
3) *Time Line:* Under best of circumstances permitting and engineering could well take another two years. The earliest possible construction date under best of circumstances would be the fall of 2013, more likely the fall of 2014. Permits have a shelf life of about 5 years so we do have a little time.

I look forward to meeting you all at the annual meeting and discussing these matters. It's been a pleasure to be your president.

Sincerely, Philip Ceriani, MD , President