

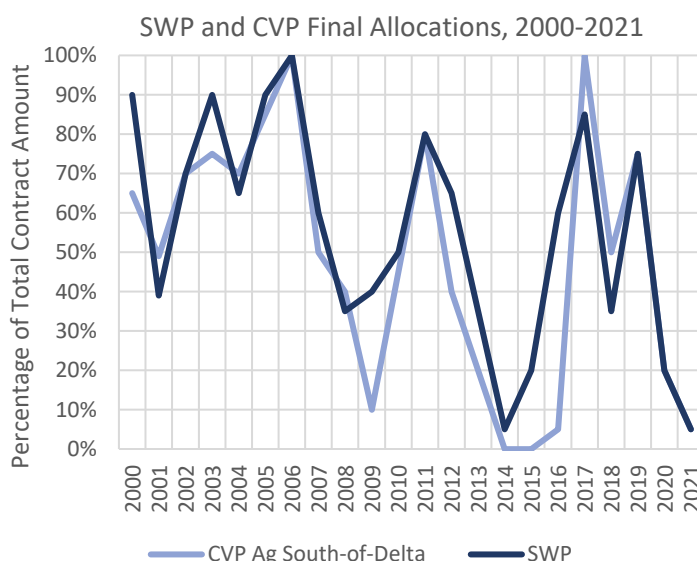
Water Market Insider

WestWater Research is the leading economic and financial consulting firm in the water industry.

California Water Project Allocations Drop; Nasdaq Veles California Water Index (NQH2O) and Futures Jump Nearly 30%

Hot on the heels of a dry 2020, California is facing a critically dry 2021. Generous precipitation from atmospheric river events in January and February was insufficient to improve the State's water supply outlook.

On March 23, the California Department of Water Resources lowered the 2021 State Water Project (SWP) allocation to 5%. That means the 27 million Californians and 750,000 acres of farmland that rely on water supplied from the California Aqueduct will receive only 5% of their total water deliveries contracted from the State. If the SWP allocation is finalized at 5%, 2021 will be only the second time in the SWP's 60-year history that allocations have been so low. Typically SWP allocations are finalized in April or May.



Sources: California Department of Water Resources and United States Bureau of Reclamation. Note 2021 allocations are not yet finalized.

Following suit, the United States Bureau of Reclamation announced an update to 2021 Central Valley Project (CVP) allocations. Citing worsening hydrologic conditions, agricultural CVP contractors located South of the Delta will receive a 5% allocation. However, that water supply will not be available for delivery until further notice.

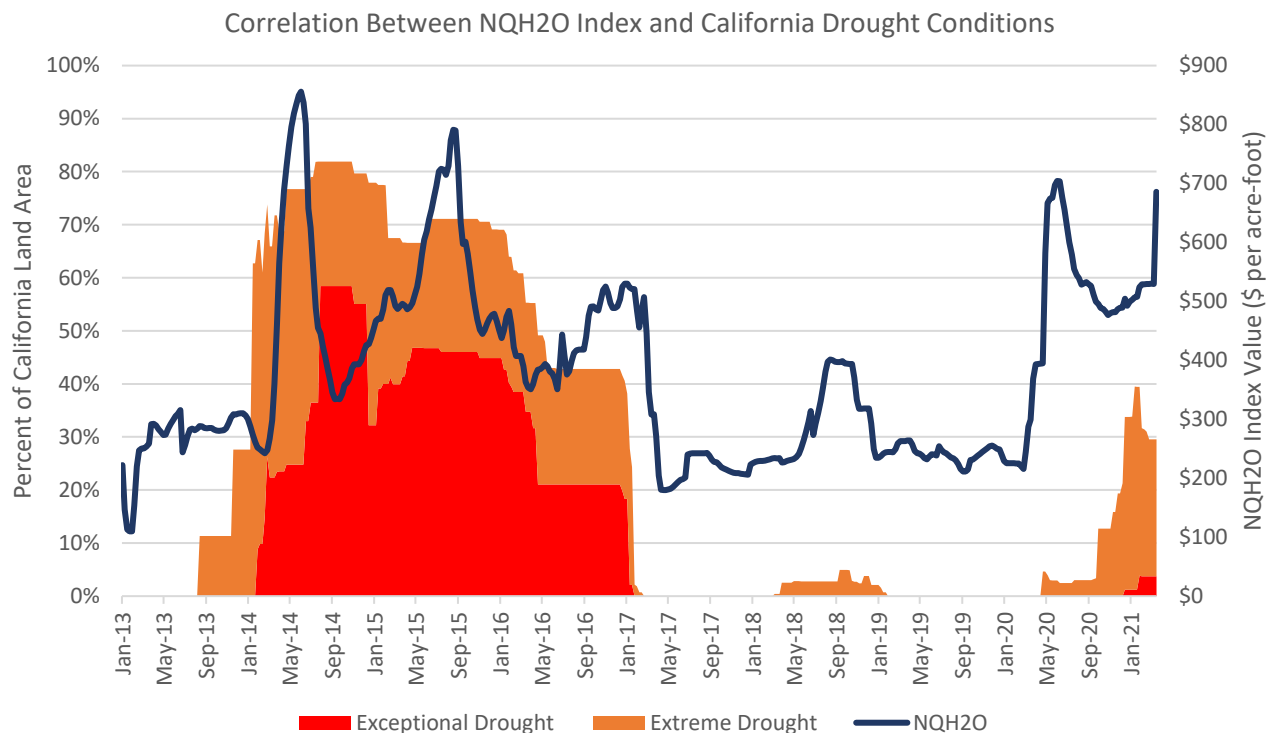
During critically dry years, agricultural and urban water users turn to the spot water market to procure additional supplies. In 2014, the last time the final SWP allocation was 5%, competition among buyers drove spot water prices to record highs. Some transactions were completed at prices up to \$2,200 per acre-foot during peak irrigation season. Fruit and nut growers were the high bidders, struggling to maintain crop yields while almond prices soared above \$3.50 per pound.

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After Tuesday's SWP and CVP allocation announcements, the Nasdaq Veles California Water Price Index (NQH2O) jumped on Wednesday by nearly 30% from approximately \$530 per acre-foot to \$686 per acre-foot. The NQH2O index serves as a benchmark for CME Group's Nasdaq Veles California Water Index Futures, which were up more than 27% on Wednesday morning. This increase was driven by the recent completion of several spot water transfers purchased by permanent crop growers in the San Joaquin Valley. Prices paid in recent transactions ranged between \$600 and \$900 per acre-foot. One small-volume transfer was executed at \$1,300 per acre-foot, representing the high-water mark for 2021 prices to date. Additional spot water transfers are currently being negotiated at similar prices but have not yet been consummated.

In previous dry years, the NQH2O index has risen quickly during the summer irrigation season. Further, water market prices and the NQH2O index have become more sensitive to drought over time. In 2014 and 2015, the NQH2O index hit the \$600 per acre-foot mark only after approximately 70% of the State was in exceptional or extreme drought as defined by the United States Drought Monitor. More recently in 2020 and 2021, the NQH2O index rose above \$600 per acre-foot with less than 40% of the State in exceptional or extreme drought. Farmers and other major California water users will be watching the NQH2O index and futures closely in 2021 as peak irrigation season approaches, and water supply conditions worsen.



Sources: Nasdaq and United States Drought Monitor, The National Drought Mitigation Center

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