

Water Markets 2008/09

“Whisky is for drinking, water is for fighting”

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Factors affecting value



- Commodity prices
- Interest rates
- Exchange rates
- Seasonal conditions
- Domestic government policy
- Foreign government policy

Foreign Government Policy



- Foreign government policy can impact on Australian farm gate returns as we are export focused for many products;
- Examples of impacts include:
 - Tariffs and subsidies
 - Mandates on Biofuel use in EU, US, Brazil, and Canada



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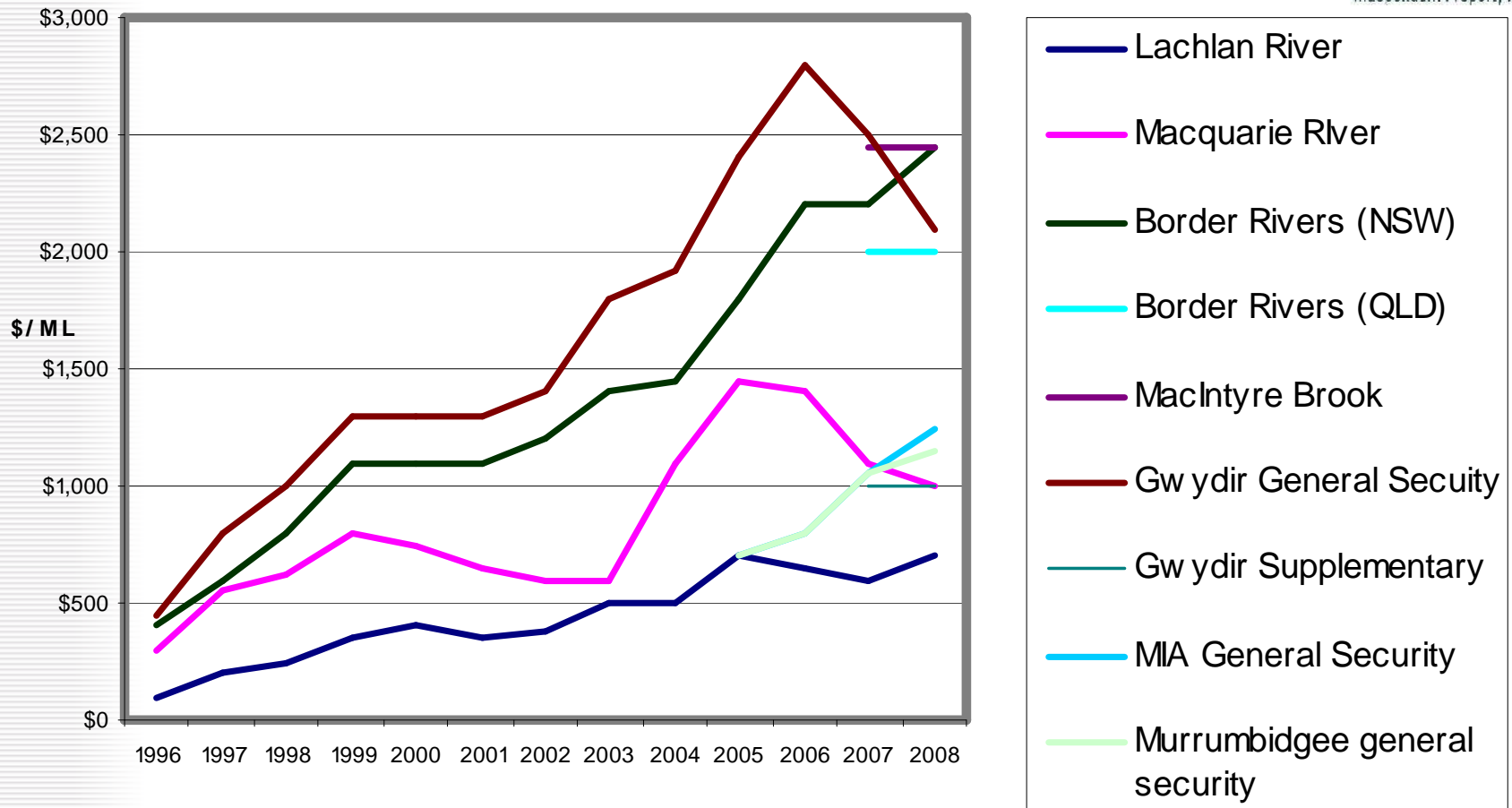
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Factors affecting water values



- Demand vs available supply
- Value of cropping options
- Resource reliability
- Security of tenure
- Transferability
- Type of water property right
- Location and environment

Trends in water values





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History of water reform



- 1994 – CoAG Agreement
- 2000 – New State Legislation QLD and NSW
- 2000 – Moratorium on further development in QLD
- Water Sharing Plans and Resource Operations Plans
- 2004 – National Water Initiative (NWI)
- 2007 – National Plan for Water Security
- 2007 – Water Act 2007
- 2008 – Water Amendment Act 2008

ROPs and WSP



- Define the availability of water in the Plan area
- Provide a framework for sustainably managing water and the taking of water
- Identify priorities and mechanisms for dealing with future water requirements
- Provide a framework for establishing water allocations
- Provide a framework for reversing, where practical, degradation that has occurred in natural ecosystems, including, for example, stressed rivers; and
- Regulate the taking of overland flows.

National Water Initiative



- Introduced in 2004
- Expansion of permanent trade.
- Introduction of initiatives to assist in a more cost effective and flexible recovery of water for environmental purposes.
- More secure water entitlements with an agreement on the sharing of risk in the event of reductions in water availability.
- A more holistic approach to water management recognising the relationship between surface and ground water resources.
- Better and more efficient management of water in urban environments, for example through the increased use of recycled water and storm water.



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Valuation Of Irrigation Properties and Water Rights



- Water is an asset and an input in the agricultural production process;
- Need a common denominator eg \$/Average Cotton Ha;
- Water is used in conjunction with specialised infrastructure;
- Transferability of water can add to its value – some rights more transferable than others as there is less risk of stranded assets if water is removed;
- Value in-situ may be different to value if sold separate to land;
- Most efficient users have a competitive advantage in the market;

Water Act 2007 and Water Amendment Act 2008



- Water Amendment Act 2008 came into effect on the 15 December 2008;
- Designed to give effect to the intergovernmental Agreement on Murray Darling Basin Reform which was signed on the 3 July 2008
- As agreed:
 - Transfers the current powers and functions of the Murray Darling Basin Commission to the Murray Darling Basin Authority (MDBA).
 - Strengthens the role of the ACCC
 - Requires the Basin Plan to provide for arrangements for meeting critical human needs.

Murray Darling Basin Authority



- Key Functions

- Prepare Basin Plan – set sustainable limits on all extractions, identify critical human water needs;
- Advise Minister on accreditation of state water resource plans;
- Develop water rights information service to facilitate water trading;
- Measuring and monitoring water resources;
- Gathering information and undertake research;
- Engage community in day to day operations;
- Manage day to day operations of the River Murray System;
- Undertake works as agreed by the Murray Darling Basin Ministerial Council

The Basin Plan



- The Basin Plan will be complemented through water resource plans prepared by the Basin States and provided to the Commonwealth for accreditation;
- Where the Basin Plan identifies a need for a reduction in long term average diversion limit, it will also identify the percentage of that reduction for which the Australian Government is responsible;
- Where improved knowledge about how much water is needed to protect the environment could have an impact on irrigators, the Australian Government will bear all of the government's share of the risk to irrigators compared to the previous share arrangement with the states.

Government Water Buyback



- Various state governments have been operating quietly to acquire water for environmental purposes over the last few years;
- In 2008 the Commonwealth Government publicly announced a water buy back program as part of buying water for the environment to assist in long term sustainability
 - Restoring the Balance Water Entitlement Purchase Program
- Department of Environment Heritage and the Arts (DEWHA) is the management agency

Government Water Buyback – Restoring the balance



- Objective: to make immediate progress in providing more water for the environment
- Approach: enter the market to acquire water entitlements for the environment
 - Entitlements to be managed by the Commonwealth Water Holder
 - Budget \$3.1 billion over 10 years

Source: DEWHA “Water for the Future – Restoring the Balance”

Government Water Buyback



Criteria for Assessing Offers

- The entitlement must be in a catchment where scientific evidence suggests that more water is needed for the environment.
 - CSIRO Sustainable Yields
 - MDBC Sustainable Rivers Audit
 - High value ecosystems – eg. Narran Lakes
 - System health
- The entitlement must allow water to be managed to provide an environmental benefit.

Government Water Buyback



Points to consider

- Financiers will need to ensure that their security position will not be eroded with the sale of water from property held as collateral;
- For larger transactions, advice on values of water and/or values on retained assets maybe of assistance;
- Some water assets are more difficult to assess a value on as there is no reasonable volume of sales evidence, however it still has a value;
- A review of the Basin Plan may see some allocations reduced, at the end of the current plan, as a result of a reduced long term average diversion limit.
 - How will value be assessed as not all licenses have a transparent market, and will value to the owner be a consideration, in particular the potential loss in value of the associated infrastructure?

Government Water Buyback



- Compulsory Acquisition by Fed Gov't
 - Just terms – Section 51 (xxxix) constitutional guarantee of the rights of ownership of property and to proper compensation if the property was resumed by the Federal Government
- Could this impact on the activities of the government in the future management of Australia's water resources?
- ICM (Doug Shears) is mounting a legal challenge against the Federal and State Government for the taking of water in NSW on the basis that "just terms compensation" was not paid.

Outlook



- Strong commodity prices – demand driven not supply driven.
- Change of focus from just food and fibre to food, fibre and energy production.
- Improved seasonal conditions will allow agricultural enterprises to take advantage of strong world commodity prices and opportunities to make above average returns.
- New investment capital is being introduced into this market segment which has traditionally shied away from agriculture.
- Adoption of new technology to continue productivity gains. There are still significant opportunities for further production gains in many rural industries.

Outlook



- **The top 25% will continue to expand due to best management practices throughout their whole enterprise.**
- **Increased institutional investment.**
 - Increased awareness of agribusiness and better fundamental economic outlook for rural commodities will increase the attractiveness of agri investment;
 - Move away from tax driven MIS
- **Increasing level of affluence in the world population.**
 - Increasing demand for better quality food and larger quantities of food.
- **Agricultural land is reducing in availability due to land degradation, urbanisation and increased forestry.**

Issues for investors



- Land tenure – freehold/leasehold
- “water ain’t water” – water rights are not homogenous
 - Differentiate between the different water rights associated with a property and their respective productive potential and security of tenure;
 - Understanding the operation of water rights within a particular system.
 - Ensure common denominators are used when comparing.
- Do a thorough due diligence process:
 - May require expert reports from hydrological engineers to model historical water reliability. Once completed they are a powerful management tool;
 - Understand the land use capability of the land asset.
- Long term patient capital required.
 - Investors need to be aware of the variability associated with climate and other production risks.



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