Rural

HERRON TODD WHITE RURAL

Overview

This month sees Queenslanders happy with State of Origin and looking forward to the Ekka, the annual Brisbane Show. Normally associated with bringing the colds and flus to town on bitter westerly winds, this year the cool nights and warmer days may see a change in the air, and dry air it is. From WA to Queensland and a lot of country in between there is a deficit of rain for the cropping and grazing sectors. It will be interesting to see the grain prices this harvest and the impact this will have on the intensive feed industries of cattle, sheep, pigs and chickens. These finishing industries have recorded good sales volumes over the past two years benefiting from increased commodity prices and falling feed costs. It may be that these two factors start to reverse and understanding where relative value sits going forward will be a challenge in the next 12 to 18 months.

The other emerging trend is that land transactions are being negotiated with a lot of door knocking and not always by agents. This additional demand to find an asset at this high point in the market cycle suggests some caution and one hopes that proper due diligence is being considered in these buying decisions.

Access to water is a key comment this month with the latest Queensland allocations release. Roger Hill has provided a high level overview on this market relative to the previous three rounds and proves interesting reading. The access to, use of and reliability of water continues to be a strong driver for land sales where higher value crops or permanent plantings are replacing traditional land use. There is still capital for such new developments but finding the right combinations of land, water, region and supporting infrastructure is proving a challenge for this capital.

So as we move from winter to spring, fingers are crossed for some good spring rains to lead into a better summer season for all broad acre industries and hopefully the continuing of positive on farm returns can be seen again in 2017/18.

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Water for northern industry development – what price should northern water be?

Industry stakeholders have all voiced their welcoming of Minister Anthony Lynam's recent announcement of the release of 92,500 megalitres of water in the Flinders and Gilbert River systems.

This round of allocations is proposed to be at a fixed price. That is good too, isn't it? Well, perhaps!

What price per megalitre is going to hit the nail on the head for northern agricultural industry development this time?

Has there been any mention of tradability? Or will these allocations be tied to the parcel?

What development covenants or policies are going to complement the price so that collectively, government and industry can look back in ten years time and say, "we did get it right that time"?

These are simplistic questions, but they need to be addressed by all stakeholders.

Remember, this has to be a win win for government, landholders, local towns and communities and investment partners (be they equity investors or debt raised through the banking sector).

Pricing

There are various methods to determine the price. These should all be considered independently in such an immature and developing market area.

There are both bottom up and top down methods to calculating the price for water. Independent advice should be sought to ensure that the water price modelling is appropriate.

There is some relevant market history in the local area. Careful consideration is required to contemplate the price discussion with the result:

1. The first round of allocations for the Flinders and Gilbert River averaged $36 per megalitre.

The result: industry was unhappy with the division of allocations. Government was unhappy that none of the allocations were utilised and local communities missed out on any economic benefit;

2. The second round of allocations saw government implement more structure to the distribution via reaches. To force industry to use the allocations, the minimum bid of $46 per megalitre model was introduced.

The result: Limited successful tenders, lots of talk, no benefit to communities and no projects developed;

3. In 2016 there was an opportunity for graziers to purchase Great Artesian Basin Sustainability Initiative (GABSI) allocations which were to be attached to their bore supply. The price was fixed at $1,430 per megalitre.

The result: Government said there was low demand due to only a small uptake. Industry buyers were scared off by the price. Industry commentary was that had the price been reasonable, then there would have definitely been more applications and acceptance of the offer documents.

These three examples demonstrate the importance of the price relationship to covenant, allocation and policy design.

So, what broader market price parameters are relevant?

A quick survey of the Herron Todd White independent rural valuers around Queensland yielded the following:

Southern Queensland

- Current trading price range for high security water is $3,000 to $4,000 per megalitre. High priority (100% reliability) water across the Border Rivers and Gwydir River systems in northern New South Wales where delivery infrastructure is in place and the water is used for irrigating intensive agricultural and orchard type crops.
- Majority of water trading in this area is medium priority or supplementary (water harvesting).
- Medium priority water has water delivery infrastructure in place (landowner owned). This includes pumps, supply channels and dams. Medium priority water is used for broad scale irrigation (eg cotton). This water is trading from $1,750 to $2,200 per megalitre and peaking around St George to $2,500 per megalitre.
- The lowest priority water is from water harvesting. In New South Wales this is called supplementary, in Queensland this is called unsupplemented water. These allocations use the same farmer owned delivery infrastructure as medium priority allocations.
- In Queensland, the unsupplemented water (Condamine and Balonne Rivers) allocations form the highest volume of market trades. These allocations trade for about $1,300 to $1,700 per megalitre in Queensland and a slight discount in New South Wales.

Key points to consider here:

1. Mature water trading market;
2. Established high gross margin industries;
3. Established knowledge capital on how to grow high gross margin crops;
4. Development finance and capital not required as the scheme is established;
5. Established financial relationships with experience with water and irrigation returns on investment risk parameters so that debt funding and equity instruments can be written;
6. Infrastructure is developed and is working - there is no development risk;
7. The free market scarcity (demand) has driven the water price to these ranges;
8. The towns and communities have developed a workforce, service centre and infrastructure to support the surrounding industries.

Central Queensland

- Medium priority sales are ranging from $1,700 to $1,900 per megalitre;
- High priority sales are few and far between and peaking at $2,500 per megalitre.

The above points regarding industry maturity, high gross margin crops, developed infrastructure and communities are relevant again.

North and Far North Queensland

- Atherton Tablelands water is trading at an all time high of up to $3,000 per megalitre due to the scarcity of water. This scarcity arises not just due to the drought, but also due to the cropping area expansions being such that crop demand is much higher than the allocated water.
- Burdekin. Limited trades at all. There is no scarcity. This is an immature trading market. The irrigated production areas are the same size as they were when the allocations were detached from the land titles so there is no increase in demand above the allocations that farmers already have. Reported value apportionments in sale contracts of farm, water, plant, crop is reported to range from $50 to $70 and sometimes $90 per megalitre.

The previous points regarding industry maturity, high gross margin crops, developed infrastructure and communities are relevant again.

Further development considerations:

The initiative to develop a project must also provide adequate return to the investor, farmer or grazier developer and financier.

In time, the broader goal is for high gross margin crops, however the first incubator irrigation sector is the fodder crops for hay and silage.

You might recall that in 2012/13, hay was in short supply and was being trucked from southern districts. Hay farmers in north and north-west Queensland that year experienced peak demand and high gross margins.

As soon as it rained late last year and when cattle numbers reduced, the contrary situation existed. There was limited demand and of course, no gross margins (possibly even a loss).

It is evident that the gross margin volatility is an economic issue – not all is smooth sailing and this is a risk that the industry has been worried about.

Bearing in mind the three local market instances of pricing mentioned earlier and the broader established market information, the question arises as to what price can be afforded for the water given the value of the land underneath the farm site, the investment in earth works, water works and seed to create a crop.

Investment decisions require prudent consideration of a profit/value return for the effort and risk taken to develop a project.

Why would an investor (in this case, a grazier/farmer, banker/investor) inject capital in such a project if there was no capital value return?

There is an opportunity cost and a rate of return required to make such a development decision to evolve the business model to incorporate the farming activity and potentially create employment within the wider community.

A recent exercise with one of our trading type grazing clients identified that for the highest and best use of the grazing land to be better and put to a farm project, the hurdle rate of return had to be greater than 15% off tight Mitchell Grass Downs.

From an urban development perspective, 15% is likened to a basic subdivision project, not the development of a farming block harvesting water from the Flinders River or Gilbert River!

This hurdle rate of return has been used in the following straight line back of the envelope development model example. You might choose to use a higher risk to represent that of the seasonality of water harvesting.

There is sales evidence in the north and north-west Queensland rural property market where the added value of fodder crop farming areas range from:

- $2,500 per hectare (this was a mortgagee sale of a western block that was not in production, the soil required re working; had an empty earth storage tank and is exposed to the seasonality of gulf river harvesting); to
- $8,500 per hectare for an area under centre pivot on a larger cattle station (in use; established to Rhodes Grass farm; pumping from a year round reliable river source).

If one of these projects were to be developed on a downs grazing block then perhaps the added value rate might be $5,000 per hectare once established in this example.

Further considerations:

- Planting cost - $300 per hectare;
- Development cost – removing the Mitchell grass, laser levelling, constructing bays, and laying pipelines from the bore - roughly $3,000 per hectare.
- Grazing land sales suggests the underlying grazing land rate of $300 per hectare ($120 per acre).

The following model (demonstration purposes only – not a valuation, so use your own inputs especially if you are proposing higher gross margin crops) applies these variables to provide industry with a calculation model to determine how much capital is available for the acquisition of the water.

Component	Rate	Result
End value rate for the project to the larger grazing property upon which the project is to be developed		$5,000/ha
Less hurdle rate of return for developing the project	15%	$750
Provides available capital funds for development of		$4,250/ha
Less seeding cost		$300/ha
Less land/water infrastructure development		$3,000/ha
Less grazing land value component		$300/ha
Results in available capital for water purchase		$650
Irrigation water budget for crop requirements:		
Megalitres per hectare	10	
Price per megalitre		$65/meg
Megalitres per hectare	15	
Price per megalitre		$43/meg

This model provides only one example of pricing methodology at a low risk, low return rate of 15%. Pricing in a higher risk would lower the available capital to spend on the water.

The larger scale operators will employ the use of discounted cash flow analysis to give dynamics to the timing of each stage of the respective projected capital expenditure and the expected cash inflows.

The interesting point here is this basic, back of the envelope model provides a similar range to the previous pricing of the first and second rounds of allocation tenders.

Perhaps the covenants and policy need to be collaborative to actually make good use of this opportunity.

Collectively, what do you think is relevant to ensuring a win win so that in ten years time, industry and communities have grown positively?

Should co-investment by government in infrastructure be explored perhaps?

What about financial structure around the purchasing of the allocations? Debt may not be available from existing channels to acquire the allocations and then to construct the farming project.

Perhaps the financing of the allocations can be on a progressive payment basis. You might be aware that this has happened before in the form of freeholding leases.

Perhaps the ballot system, similar to that of the Brigalow Scheme would be worth re visiting.

Through collaboration with the investors/financiers, the structure of the allocation payment scheme may help to finance the project development.

Is there any reason why access to development funding cannot be sourced or co-secured by government?

It is noted that government sought to implement an initiative to force the use of allocations in the second round. Perhaps a requirement for the allocation funding agreement and structure would result in a time frame for development and use of the allocation.

As industry stakeholders have stated, this is a good opportunity, however a collaborative approach will be required to address stakeholders' needs so that this announcement does in fact materialise into being a winner for North Queensland.

Contact:
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Southern Queensland

Well we all knew it was coming, but now there is no doubt it has arrived.

There is now a broad range of evidence to suggest the southern Queensland market is on a run. Whilst it is obvious that the increase in the market to date has not been consistent across all the regions, there is a broad level of momentum building. There are sectors and industries out there that always lead and this time around it would appear to be no different with cattle again appearing to be the catalyst for demand. Hindsight is a wonderful thing but given that there has now been a shortage of cattle in Australia for the past 12 months or so, the likelihood of an upward market adjustment of this nature occurring was always on the cards. The issue is however how far will it go?

The golden triangle of Taroom, Roma and Wandoan has set the pace. It is now evident that over the course of the past 12 to 18 months, the market within this sector has risen by 25% to 35%. In some instances where adjoining owners are involved, this increase is even higher.

Recent settled sales include Bracco, north-west of Roma selling in September 2016 for $2,439 per hectare ($1,000 per acre in old terms); Myrnong in a similar location selling at auction for $2,523 per hectare (just over $1,000 per acre) and Nardu north-east of Roma selling for $2,151 per hectare ($870 per acre). This evidence would suggest that where previously it was accepted that an adjoining owner had the ability and was prepared to pay a premium, that premium was in the order of 10% or so; one fully justifiable. However that accepted level is no longer evident. We would suggest that such premiums could be as high as 20%. Whether they are justifiable or not is another question and one that can only be answered by the buyer.

We also note a run on irrigation country on the inner downs. Sales advised as occurring, but yet to be fully confirmed include Warra Warra at Brigalow, Bandawing south of Bowenville and Campbells at Tummaville. Initial unconfirmed evidence would suggest that there is some market movement occurring in this sector as well, but until they settle, we cannot confirm to what extent.

It is also common knowledge that Clover Downs at Cunnamulla has also gone for circa $27 million. The corporate owned holding of 125,295 hectares is a trophy holding that was acquired by Hassad Australia in July 2010 for $18.576 million. If this sale proceeds, it will reflect an increase in the order of 45% over seven years.

These are just some of the examples of recent transactions. The big takeaway from all this is that the evidence suggests that the upward market adjustment is not just limited to one sector. Broadly we are seeing a uniform adjustment in the market, something that has not been seen for a long time.

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South-western Victoria and south-east South Australia

The rural market in south-east regional Australia and more particularly western Victoria and south-east South Australia continues to out perform many other investment markets in recent months with capital growth in most sectors and regions continuing to provide strong evidence of growth. The past twelve months has seen significant focus on the south-west of Victoria from the corporates and the media which has helped to fuel interest in the area and in turn resulted in record land prices and limited available supply of land left in the market. The story is similar across the border in South Australia with recent sales displaying 20% to 30% increases in land values in the past 12 months in some areas, especially around Robe, Penola and Naracoorte.

A recent move of savvy investors away from these traditional regions of focus and toward other now more affordable regions in comparison is starting to emerge. A great example of this is RIFA's recent purchase of a circa 4,500 hectare holding near Wycheproof in the north-eastern Wimmera region of Victoria. The purchase, although at a premium price for the area at circa $9 million, resulted in a lower cost of production for the purchaser in comparison to buying a similar scale asset in the western districts.

Outside of the more traditional cropping and grazing sectors, the increase in interest in viticulture and horticulture assets is continuing with local growers looking to expand and corporate buyers seeking investments with higher returns than traditional cropping and grazing assets.

Irrigation water and areas available for future development continue to play an important part in the investment criteria for most buyers.

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Mildura

Demand from corporate entities for rural land has not waned, with strong interest still evident for both established horticultural properties and greenfield sites in the region. There has also been a much higher volume of sales of smaller properties within the local irrigation districts of Merbein, Red Cliffs and Coomealla, with most buyers intending to re-plant to table grapes or citrus.

Many of these sales are being privately negotiated, and this is a source of frustration for local real estate agents who appear to be being by passed in the process. In effect, we are seeing prospective investors 'door knock' property owners who have properties which meet their investor strategy and profile requirements, irrespective of whether they are for sale or not. This is a significant change from what has happened in the past. This demand has contributed to a substantial rise in values.

Maybe there is potential for the measure of privately negotiated sales to become a barometer for where we sit on the property clock.

A quick look at sales activity in the Merbein irrigation district suggests that the number of sales in the past 12 months is approximately double the historical average. Merbein included a number of 'dried off' former wine and table grape vineyards, and so the current redevelopment activity is a welcome site. Buyers have been attracted by the ability to secure parcels of land containing over 15 hectares.

Some buyers are in effect joint ventures between local growers and export companies, ensuring access to the funds required to redevelop, to table grapes in particular. There is also understood to be some buyer interest from solar power companies, wanting to buy sites to install ground mounted solar arrays. Underlying land values in the Merbein area in the period up to around 2014 had been in the range of $7,000 per hectare to $10,000 per hectare, however stronger buyer activity in the past two years has resulted in current levels firming to over $20,000 per hecatare.

The dried fruit industry has enjoyed a resurgence in the Sunraysia and Riverland SA region over the past three to four years. Approximately 95% of Australia's dried grapes are grown in the Sunraysia area as the region's climate, soils and irrigation are well suited to this crop. The main varieties grown comprise sultanas, currants, sunmuscat and raisins.

Mike Maynard, CEO Australian Premium Dried Fruit, (based in Mildura) reports that the 2017 total crop volume was down a reported 25% to 15,000 to 16,000 dried tonnes due in part to the hail storm in November (10% loss in Cardross, Red Cliffs and the Riverland). The yield was also affected by poor seasonal performance of sultanas, attributed to cool/wet conditions in late 2016. Sultanas still make up the main variety and have a tendency to biennial production.

Sunmuscats, currants and sunglo (a new sultana replacement) all yielded similar to the excellent 2016 season despite lower sugar levels however sultanas, which represents 54% of the total planted area, was down up to 50% in 2017 compared to 2016. Mr Maynard suggested that the "2017 season really drove home the argument for growers to consider pulling out sultanas and replacing with better performing varieties such as sunmuscats and/or sunglo".

Prices were up on average about 3% on 2016 levels.

Property sales activity has continued in the past month with several properties across all agri sectors transacting and due to settle shortly. The clear message is that value levels across all sectors remain firm. We expect to be in a position to report back in the next MIR of settled sales of interest.

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Echuca

Interesting times as many look to the heavens for follow up rains after an excellent autumn break. Interestingly there has been some improvement in sales rates for medium sized irrigation properties at a local level ($500,000 to $1.5 million) around irrigation. Value levels appear to be edging higher for irrigation holdings and it will be interesting to see how this progresses under the current water resource position across the irrigation districts. Interestingly an improved forecast for farm gate milk price may spurn some interest though it is likely that most producers will have work to do to regain ground lost in the 2016/17 season.

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