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Proposed Plan for Murray Darling Basin

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The Australian Bankers' Association (ABA) and its member banks appreciate the opportunity to be involved in the consultation process concerning the Murray Darling Basin water reform proposals.

The ABA and its member banks have been working with State and Federal Governments on water reform initiatives since the early 1990s.

The banking industry has an interest in water reform from multiple perspectives. As lenders we have an interest in anything that impacts on our customers' ability to operate, including the ability to generate cash flow to meet their financial obligations and grow their businesses. We also have an interest in the robustness of the title to their assets that we hold as security. Since water was separated from land under the National Water Initiative, water entitlements can make up a significant value of an irrigator's total assets.

A reduction in water allocation and consequent reduction in agribusiness farming and investment will flow through to the economies of the Basin towns and communities including those businesses up and downstream from the farm gate.

Bankers are also a part of the Basin communities - banks are major employers and have significant branch and other infrastructure invested in regional Australia. We have a strong interest in a continuing prosperous and sustainable regional Australia.

We recognise the challenges posed by managing water as a scare resource. Policy changes must address this scarcity while minimising any negative economic impact and this means supporting a sustainable river system while also maintaining viable regional communities and productive agriculture.

In implementing a Basin Plan, consideration needs to be given to how best to support communities that will be adversely impacted.

National Water Initiative

In 2004 the ABA joined with the Australian Conservation Foundation (ACF) and National Farmers' Federation (NFF) to provide Australia's political leaders a set of principles to guide the Council of Australian Government's National Water Initiative.

The principles agreed to by farmers, environmentalists and bankers were encapsulated into the National Water Initiative agreement, including the need for water entitlements to facilitate access to finance on similar terms as land when used as security.

Given the impact on bank security of separating water from land the industry has been consistently advocating the need for robust titles for water entitlements that are suitable for use as security for loans. This was reflected in the National Water Initiative agreement. While some States have appropriately addressed this issue (QLD, NSW, VIC) others have not.

A nationally consistent water trading regime that is both liquid and gives rise to more stable prices would give banks more surety in their ability to lend against water as security. Further, the strength of water entitlements as security can vary depending on how they are governed; a more consistent approach would be favourable.

This is important not just for the continuity of the provision of finance but also for the financing of the trade of water.

It was recognised in developing the principles that water for the environment would need to be recovered to restore rivers to an acceptable level of health and that in doing so there would be an impact on communities. To minimise these impacts on communities it was identified that water for the environment would need to be recovered by water efficiency savings, improved infrastructure and with water purchases from willing sellers.

It was recognised in developing the principles that uncertainty needed to be managed by having processes that were transparent, consultative and informed by science.

These key principles remain relevant to the work of the Murray Darling Basin Authority.

Banks support policies for the sustainable resource management of water nationally, as incorporated in the principles and reforms adopted by COAG since 1994. We are concerned that uncertainty inherent in the MDB reform model may result in a reduction in the availability of finance and less favourable finance terms and conditions, in future, for agribusinesses.

Economic contribution of Murray-Darling Basin agribusiness

The Murray-Darling Basin (MDB) is one of Australia's largest drainage divisions and covers approximately one million square kilometers or one-seventh of the continent. It stretches from Queensland's channel country through NSW to the Australian Alps, Victoria's north-east and the Riverina, and on into South Australia's Riverland and the Coorong at the mouth of the Murray.

The Murray-Darling Basin hosts a significant percentage of Australia's agribusiness with:

- 85% of all irrigation in Australia taking place in the Basin, supporting an agricultural industry worth more than $9 billion per annum; and
- 40% of all Australian farms, which contribute 39% of Australia's gross value in agricultural production.

Estimates prepared for ABA member banks indicate that the economic impact of agribusiness is magnified due to the multiplier effect in regional communities- every dollar from on-farm production has a multiplier earning effect across Agribusiness Pre- and Post-Farm Gate of 1:5.

Banks' role in supporting agribusiness

Banks play an important role in providing agribusinesses access to credit to operate and grow their business.

When assessing lending applications banks consider the borrower's track record, the cash flows of the business and the value of security offered. Under the National Water Initiative, water title was removed from land title and, subsequently, water entitlements became a major source of value and security in seeking finance (for the farmer) and lending to agribusiness (for the banker).

Reduction in water allocations, whether forced by climate or through buy back/allocation impacts production and hence borrowing capacity.

Outside of drought times, property values are based around willing seller / willing buyer sales evidence and also influenced by productive capacity of the property. Very few properties are selling in the Basin at the moment due to the economics of drought and uncertainty surrounding national water policy. Of material interest to lenders is the impact any water allocation buy back will have on the underlying value of the remaining land asset and productive capacity.

Murray-Darling Basin – Guide for the Proposed Basin Plan

The ABA supports the development of a balanced plan for the Basin. However, the scale of the reductions proposed in the *Guide for the Proposed Basin Plan* are expected to have serious economic and social consequences for irrigators, businesses and the communities that have developed over many decades to support irrigated agriculture, including in the dry years.

Implications of the Guide

Uncertainty impacts investment

The Guide, if enacted, would dramatically impact the productive capacity of irrigated businesses in the Basin (typically family-run), which would in turn jeopardise the ongoing access to finance.

Further, the Guide has generated uncertainty which has impacted confidence and therefore investment in the sector. We have seen this have an immediate impact on the saleability, and potentially the value, of several large scale assets, farmland, businesses and housing in areas potentially impacted by the Guide's proposals.

Uncertainty has also been generated by a lack of clarity as to what the actual impact will be on a region by region basis. An ongoing program of education and awareness at local level would be beneficial. Timely advice from Government about the structural adjustment support that may be provided, including a timeframe that allows for the management of structural change, would be beneficial.

Compensation – adequacy and eligibility

The Guide, if enacted in its current form, would have a detrimental effect on value. Farmers will be compensated however those up and downstream from farm gate will not. The value of businesses that provide farm merchandise will drop, as will those that trade produce, food and fibre, due to reduced production flowing through.

Farmers, in addition to being compensated for a reduction in water allocation, should also be compensated for the investment they have made in farming that water, infrastructure, plant and equipment.

Permanency of water buy back

The ABA welcomes the bipartisan commitment to only purchase water from willing sellers. This approach is important for managing potential economic uncertainty as to how water will be acquired for the environment. However there remain doubts as to whether there will be sufficient voluntary sales back to meet target, which is creating further uncertainty about how water policy may develop. From a productive capacity perspective, buy backs are permanent, which impacts the value of the farming asset and therefore ongoing/future access to finance.

Buying water for the environment needs to be balanced with measures to manage the impact on local businesses and communities.

The ownership of water entitlements with secure title plays an important role in supporting access to finance especially where they make up the majority of a farmer's assets. This is typically the case for irrigation farmers. It needs to be recognised that land values have been underpinned by the availability of water for agricultural production and despite separation of title, sustainability of production is interdependent on water in most cases. Land values in these areas have been reduced significantly with the separation of water from land. Relying on farm land as security in these areas will reduce access to finance.

The ongoing viability of irrigation infrastructure may be adversely affected if there is a significant reduction in locally owned water entitlement. As water is sold out of irrigation areas the fixed costs of maintaining the infrastructure can be expected to increase for remaining irrigators. This means that as willing sellers leave the system an unintended consequence will be increased costs and financial stress on remaining irrigators. There will be a tipping point where this cost becomes too high for the remaining irrigators.

Given the impact on real property values the sale of a significant proportion of water entitlements out of an area may also affect the rate base of local government.

Implementation timeframe

The Phase-in period of proposed water allocations in the Murray-Darling Basin, due to different State Water plan timelines, creates further uncertainty in terms of decisions about investment and lending.

Impact on local communities

A reduction in water allocation and consequent reduction in agribusiness farming and investment will flow through to the economies of the Basin towns and communities including: impact on small businesses and their ability to further invest, saleability and value of houses in towns, sustainability of rural communities and younger people moving away or off farm because of reduced opportunity.

Priorities

Investing in the productive river capacity creates jobs, supports rural towns and social cohesion, and creates profits on which taxes are paid.

The outcome of enacting the Guide will be a reduction in the number of families that live off farming and this will have a flow-on effect to the economic fundamentals of local communities.

Therefore, given the potential impacts of the Guide, the priorities for water management should be:

- Investment in *environmental water* infrastructure including investing in ways to store and move environmental water without as much transmission and storage evaporation;

- Investment in infrastructure around *productive water* both in terms of existing water and in harnessing and delivering increased water more effectively;

Where the above cannot deliver the required level of water to meet recognised and agreed environmental needs then strategies for acquiring water from markets should be adopted that minimise the amount of water that needs to be permently acquired. Subject to capacity constraints options such as banking water acquired in the temporary markets at times of surplus should be investigated.

In acquiring large amounts of water account needs to be taken of the impact on the liquidity and volatility of local markets. The Government, as a water holder, should also have a responsibility to support the liquidity of the market by trading in the market when it makes sense to do so.

Managing financial hardship

Long-term adverse seasonal impacts, now combined with the uncertainty created by the Guide, is impacting decisions concerning the value of investing on farm or with expansion, value of assets, which impact the earning ability of property.

Most of the Murray Darling-Basin has been impacted by recent drought. A number of farming businesses are highly geared as a result of a number of drought years. Many farming businesses have been in Exceptional Circumstances declared areas and are receiving interest subsidy support, although the future of these subsidies is unclear in light of the recent piloted change.

Following this extended period of drought there will be some farmers in the Murray-Darling Basin whose businesses are no longer financially viable.

We do not expect that the release of the Guide will change the way that banks manage these customers. The banking industry has a long standing and well-established approach to managing the impact on farmers and farming communities of drought, floods, bushfires, commodity price downturns and major policy changes by Governments.

Banks take a positive case-by-case approach to managing hardship and providing working capital/credit as customers have differing objectives. These include those looking to expand and/or become more efficient, those wanting to exit farming, those looking for family succession options, and those enjoying a rural lifestyle supported by off farm income.

Where a customer's equity has eroded and they are no longer financially viable, it is industry practice to negotiate an acceptable strategy with the customer for the repayment of debt. If this cannot be achieved through one-on-one negotiation, it is industry practice to offer to resolve the way forward by using the assistance of an independent mediator.

It also needs to be recognised that over the past decade the banking industry has worked hard to maintain its rural representation including the employment of local staff and in fact has been investing in infrastructure for the benefit of local communities.

A coordinate approach to adjustment with a time horizon that allows managed structural change is essential to a Basin Plan that will deliver the balance of outcomes necessary for the Nation.

Conclusion

The ABA and its member banks have met already with the Murray-Darling Basin Authority and appreciate the opportunity to continue to be involved in the consultation process.