



## THE CURRENT WATER MARKET

Water used to be an “input” to your business. But farmers fought hard for – and won – a property right for water. It is now an asset and must be managed as such. Like any other asset, you need to look for the best possible return.

### What is a Market?

A market exists anywhere there is supply and demand. A market cannot exist without both. It operates with “willing sellers”, someone who offers their asset voluntarily, to a “willing buyer”. Selling into a market may involve an intermediary. Examples of different market models include:

- Direct exchange (i.e. No intermediary);
- Related exchange (i.e. Water sold with land);
- Agency (i.e. A water broker, NB: water brokers are unregulated, ensure they have insurance and work through a trust account);
- Market Platform (e.g. ASX)

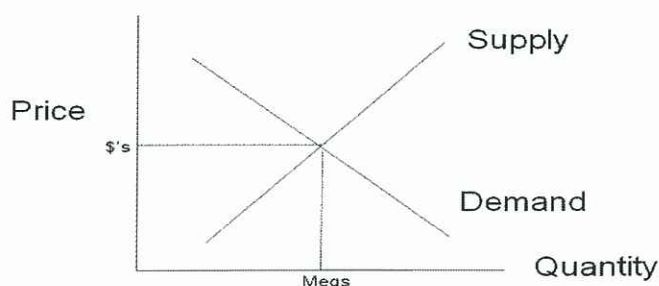
### Aims of a Market

A market exists to: (a) facilitate trade, (b) allocate resources; and (c) set prices according to supply and demand.

### Aims of the Water Market

- Asset management
- Production management
- Permanent v annual crops
- Range of water products in portfolio
- Drought protection
- Investment
- Speculation.

### PRICE SET BY MARKET:



### History of the Water Market

Contrary to popular belief, water trading in NSW is not new. The first temporary trade in NSW was sanctioned in the drought of 82/83. In the Water Market, water is divided into “allocation” versus “entitlement”. The allocation is the product itself and the entitlement is a share in the available resource.

### Development of Markets

A market develops because of an array of unregulated trade (often in an unregulated good). There are two reasons why irrigators would want to trade their water: (1) leaving irrigation and (2) staying in irrigation. As a market develops the regulation of third parties has to be considered, as the default position is to have no regulation in place. For example, equities markets and real property markets are regulated markets.

For more information about the “Farmfit” sessions near you, go to [www.rga.org.au](http://www.rga.org.au) or contact the RGA on (02) 6953 0433. We look forward to seeing you at one of these sessions.



**Australian Government**  
**Department of Agriculture,**  
**Fisheries and Forestry**



Recent developments in the water market have created an increasing trade environment and include:

- Large-scale market entry by Government
- Interest by speculators
- "Tagged" trading
- Development of market rules.

The recent interest in the water market, particularly by government, is due to the movement of resources to their highest value use. They see the water market as a solution and support the idea of a mix of water products such as is seen in the NSW split model of general security (GS) and high security (HS). Governments have already run several smaller projects, including: *Living Murray*, *Water for Rivers*, and *Riverbank*. The Federal Government has now committed \$3.2 billion for water buy back only over 10 years under *Water for the Future* program.

The Government will continue to be in the market. There is a potential for a "Commonwealth Water Buyer", who may manage the water market but will also continue to compete in it. The Government is also interested in product development. If the Government was not to participate in the water market, there is a risk of alternatives to gain water, including compulsory acquisition and/or cap reductions - both of which could impact negatively on irrigators. It may also have an effect on the market price of water.

An additional impact on water price may also come through speculators moving into the market. At present there is not a lot of benefit for speculation; although there has been an average annual return over the last 3 years of around 20%, the long-term average is only 2%. However speculators are anticipated to play an increasing role. This is not necessarily a negative element as speculators inject liquidity.

"Tagged trading" is the emergence of interstate trade. It is the preferred government model for cross border trade. However there are implications for the water product and many barriers to this kind of trade remain. Physical barriers (e.g. you can trade within a connected system); departmental barriers (e.g. taking 40 days in NSW to approve a trade and 180 days in SA); and political barriers (e.g. Victoria cannot sell more than 10% of water products interstate) are all current barriers of trade.

The Minister has asked the Australian Competition and Consumer Commission (ACCC) to develop:

- Water Market Rules (e.g. transformation which is separating an access licence away from bulk corporation licensees so trade can happen more quickly, and Infrastructure Operator business dealings rules)
- Water Charging Rules
- Bulk Water Charging Rules
- Termination Fee Rules.

### **Current and Future Water Market**

The market is still in its infancy and will change considerably in terms of scale, players and products. Trade in allocation will continue in dry times. Some operators will rely on temporary markets. The \$50m tender in the Murray Darling Basin exceeded previous market size and will be the smallest Government entry. Large-scale transfers with land can be expected to continue.

The Government can be expected to continue to be a major buyer. This support will not weaken and includes the ACCC presenting "robust" rules for water market regulation. Speculators / investment banks will also seek out opportunities to become players in the water market and irrigators will recognise asset management role.

The major changes in the future of the water market are anticipated to largely occur in the areas of products. "Tagged" entitlements will develop and become easier to trade. The Commonwealth Environmental water holder may trade. We may see insurance products develop. Derivatives will be another product we will see develop. Essentially there are three types of derivatives:

- Futures (must be able to deliver asset, this presently will not work with water)
- Options (flexibility in delivery, which will work well in the water market)
- Swaps (too hard to operate in a water market).

The River Reach program is an example of a derivative option already in place. It gives water asset owners in the region the opportunity to sell off an "un-needed" allocation in wet years, i.e. above 40%. Commonwealth and annual crop farmers are likely to be interested in this option.