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by Clare Pennington on 20 APRIL 2016 in Commentary, Q&A

Kilter Rural: balancing demands on Australian water rights

The Murray-Darling Basin Balanced Water Fund, set up last year under water and real assets manager Kilter Rural, held a first close on A$27 million ($20 million; €18 million) in November, beating its $25 million minimum target for that close. The Nature Conservancy-backed fund returns water to wetlands in abundant years and ensures water to farms in drier years. We asked Kilter Rural water general manager Euan Friday about how the water rights landscape in Australia developed, the fund's ecological aims and why it has so far been limited to Australian investors.

How did water rights develop as an alternative asset in Australia and how does Kilter Rural allow investors to access them?

In 2007 and 2008 changes in regulation in the Murray-Darling Basin separated land and water titles. Kilter's founders saw an opportunity for a water project delivering long-term investment returns while providing solutions to irrigators.

In 2009 Kilter held a close on a project on A$100 million, which is fully deployed with a book value of water entitlements at about A$160 million. We've now developed a range of water products to service irrigators, notably the recent Murray-Darling Basin Balanced Water Fund. We have undertaken purchase and leaseback transactions that mean irrigators can unlock the land value in their water entitlement without losing access to it.

We have also developed products that help irrigators manage risk around allocation price, like forward sales, and effectively provide working capital finance, built around allocations. [Water allocations provide water access entitlement holders with the volume of water that can be used or traded in each water year. The allocation will depend on seasonal conditions and particular regulations.] We have shared farming arrangements where we provide the water and take a share of the revenue from the crops. Kilter Rural-managed water is approximately 90 percent leased on long-term leases.

Who is investing in your most recent water fund and why was the first raise limited to Australian investors

I suppose [it is] because of the political sensitivity connected with water. We really wanted it to be an Australian fund investing in Australian water and delivering Australian environmental outcomes. That may change in future [raises for this fund]. There is contention over the competing demands on this limited resource.

We hope that, working with the Nature Conservancy, we will [demonstrate] that there is a better way to look at how water can be applied to competing needs.

There are 48 entities invested at the moment, including the Nature Conservancy. A number of those entities are related, so it is about 39 separate investors, behind which it's really 100 percent high net worth investors.

Why did you hold a first close in December on A$27 million when you had a maximum first-close cap of A$100 million?

We had a minimum threshold of A$20 million for the first close. We got over that and didn't want the fundraising to drag out over Christmas. There was also a transaction for a very substantial part of a Victorian Murray higher reliability [water title] that we wanted to secure. We did that with just under half of the funding capital. We've now deployed about 97 percent of capital, and are looking to raise [more capital for the fund] in the not too distant future.

How do you balance the ecological aims of your fund with the need to generate returns?

We understood as trustees that we couldn't serve two masters. Our primary obligation is to deliver the financial returns to the investors. How much water we provide to the environment is determined by prescriptive rules. In the end what it means is, if there is a very dry year, up to 10 percent of the water portfolio will be dedicated to delivering allocations to the environment, and if it is a wet year it will be up to 40 percent. Because of the environmental requirements, there is a cap on the amount of water we can encumber with leases. But we can still generate money pretty quickly. About 50 percent of the fund is generating returns from the get-go.

What do you think about strategy and horizons when it comes to investing in water rights? Email clare.p@peimedia.com