Rural

February 2020

Overview

Welcome back to 2020 and we are all looking skywards to see if the late monsoon can deliver some much-needed rainfall to many parts of the country and put out some fires, provide some pasture growth and create some solid sub-soil moisture for our cropping land.

2019 closed with some good sales and a sense there's still an underlying demand for quality rural land in most localities. That said, questions are starting to emerge such as, "What if we get good general rain on a wide scale?" Will that see a rash of new listings to the market and swamp supply, or will the market tighten further as conditions improve?

Everyone has an opinion.

What we do know is there is a fair bit of catch up and recovery to occur in relation to stock rebuilds and crop production. Also, lending is available but can be challenging, while most commodity markets have sound to strong outlooks and rural land holders are ever the optimist.

Our team are providing some thoughts on the year's close and the current conditions in their regions. We will be holding our national market updates in Melbourne and Brisbane at the end of February where we'll aim to piece the puzzle together, analysing 2019 and providing a view of the 2020 outlook (normal caveats will apply of course).

The link to the Brisbane event scheduled for 7am start Friday 28th February is below for those that may be interested

https://www.eventbrite.com.au/e/90100467925

Tamworth

Welcome rain, although patchy, has seen a positive start to 2020 for some areas across New South Wales. Isolated falls and heavier storms have begun to fill dams with reports from northern New South Wales that in one storm, dams that have been dry for two years have filled up.

Welcome water! Source: HTW

With large areas of New South Wales still affected by the ongoing severe drought, follow up rain and a return to average seasonal conditions is required before a more optimistic outlook can be taken.

There remains reasonable demand for rural land in New South Wales, particularly from existing land-holders looking to expand, and we expect this to continue throughout 2020. Values appear to be holding, however it is expected that if the drought shows signs of breaking and there is a return to normal seasonal conditions, there may be an influx of listings which has the potential to create an oversupply which may in turn lead to a softening in values over the next 12 months.

Lismore

The weather and subsequent farm production levels are foremost in the minds of farmers at the start of 2020. There is uncertainty in expected production this year for most rural industries on the New South Wales North Coast. Anecdotal reports indicate that there may be a reduced macadamia crop, parts of the sugar industry did not complete 2019 planting and ratoon crops in some areas have struggled in the dry conditions, the summer crop planting of soya beans has been restricted with the planting window to close in the next few weeks and pasture conditions for beef and dairy farmers are challenging in the dry conditions. There has been a slight upswing in world sugar prices, but a long way to go there. Lower production levels and lower farm incomes may limit farm purchase activity. The exception is farms that have rural lifestyle attributes to attract more cashed up purchasers from urban areas.

Mildura

In the horticultural sector, the overriding issue in 2020 will remain the availability of irrigation water. Catchment dam levels have been gradually lowering since the start of 2017 and substantial rainfall is required to replenish supply. Most irrigators have been able to provision for reduced allocations in the current water year through a combination of carry over and leasing water, however the cost of doing this for a further year will be tough for most producers and there is no certainty that there will be enough available water to keep all crops fully irrigated.

Data from the Murray Darling Basin Authority

Mildura Source: milduraregion.com.au/

suggests that the volume of water required to irrigate permanent horticulture crops in the region is in the order of 550 Gigalitres (GL) per annum. Of this, around 180 GL will hopefully once again be available from New South Wales Murray High Security Water Licences. The remaining 370 GL will need to be found primarily from Victorian allocations and so an allocation in the 2020/21 year of at least 35 percent for Victoria Murray Zone 7 Water Shares will be required to meet this need. The final picture will depend on the ability to transfer water between the Murrumbidgee, Goulburn and Murray River systems, with the restrictions on inter-valley trade during the past six months exacerbating the current shortage of water in the region.

It appears inevitable that some producers will elect to dry off their less profitable crops in 2020, such as white wine grapes, Valencia oranges and dried vine fruits and also bring forward the decision to clear older, less productive plantings of other crops. At the same time, we expect to see a deferral of further expansion plans. This will affect contractors, nurseries and irrigation design and supply businesses, all of which have enjoyed a period of strong activity during the past four years.

The dried fruits industry, in particular, will be vulnerable in the event of a reduced area of plantings. There are currently three dried fruit processors in Mildura and the industry will be nervously watching the production forecasts for 2021 to see whether there be enough tonnes to keep three processors going.

It also appears inevitable that values of all types of horticultural property will plateau as growers take a wait and see approach, however we don't expect to see a significant decline in values during 2020. Some consolation comes from the expectation that commodity prices for many of the region's crops will remain high, which makes leasing water at current levels of over $800 per megalitre economically feasible for some. Farmers tend to retire at a time of their choosing rather than age and we expect people will try to ride out the current drought rather than sell at a time of reduced demand.

However the smaller, less efficient growers, particularly those who rely entirely on leasing water, will be vulnerable should the dry conditions continue throughout 2020. There will be a widening gap between the balance sheets of irrigators who hold significant water entitlements and those who do not.

There are a number of reviews currently occurring into water trade and river management and while everyone hopes that this will result in improved transparency in water ownership and the trading platform, it is unlikely that we will see recommendations that will contribute to any significant reduction in the cost of leasing water. The cost will again be entirely governed by the supply of water, in particular whether New South Wales Murray and Murrumbidgee General Security Water Licences receive any allocation.

Confidence in the dryland farming communities will also hinge on rainfall leading up to the optimal sowing period in April and May. Producers were able to tap into stored soil moisture to grow a crop in 2019, however soils are bone dry at present. Values of farming properties in the Mallee region have been increasing in recent years, however we expect that buyers will be cautious until the season improves. Dryland farmers in the Mallee realise that they rarely benefit from years of both high yields and high grain prices and that a good season will inevitably coincide with an easing in grain prices.

Meat prices are forecast to stay high for several years and livestock producers in the Western Division are all optimistic about the future of their industry. Even though feed remains critically short or even non-existent on some properties, all the evidence suggests that property values will remain firm, in part due to an expectation that only a limited number of properties will be offered for sale until the drought breaks.

North and North West Queensland

The 2020 north and north-western Queensland grazing property market certainly is primed for a make or break year ahead. Off the back of the 2019 market conditions, both purchasers and vendors will need to do their homework and have their wits about them.

Major demand factors in the recent year have been from:

- Southern graziers seeking higher rainfall and grassed areas;
- Southern farmers taking a risk to establish northern dry land farming projects;
- Positive producer sentiment as cattle prices are good and are expected to rise;
- Low interest rates; and
- Commonwealth acquisitions in the Greenvale and Charters Towers area.

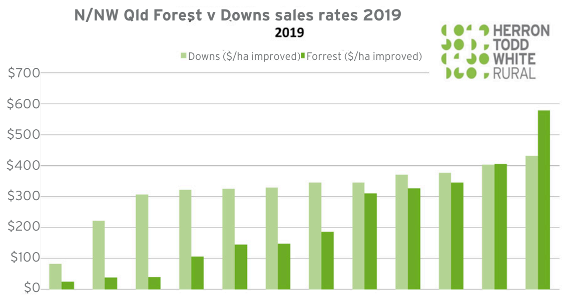
Market commentary appears to be mixed. There are some who are looking to expand in these market conditions on the back of low interest rates and confidence in cattle prices in the next five years and then there are those who believe that once it rains down south, the demand that drove the 2018 market pricing will dissipate, values may languish and market demand (and pricing) may change within weeks.

The following graph shows a cross section of 2019 sale parameters (excluding cattle and plant and equipment) that shows the contrast in market pricing between downs and forest country.

Downs country values increased from 2018 to 2019, however 2019 really was the year for the forest country types. The market for forest country outshone the downs for once.

Typically, downs country reflects stronger hectare rates to the forest breeding. Given the strong demand and offerings of mixed to top quality basalt country, the forest country has come through and toppled the downs.

Sale hectare rates for mixed quality to top quality basalt country in the Charters Towers and Greenvale areas achieved similar (and in the cases of Reedybrook and Marionvale, stronger) hectare rates than the downs last year (see graph).



It is time to be careful and calculating of the risks in buying or selling cattle stations at this stage of the property market cycle.

A few market comments have started to appear that have not been around since about 2006 to 2008. These were bullish comments then and are indicative of confidence rising now. For some, their investments worked. For others, bullish expansions resulted in unfortunate situations. Perhaps the variance in outcomes arose from calculated due diligence processes for the successful manoeuvres as opposed to emotional acquisitions that stretched all available resources.

An example of a comment that has recently surfaced again is the classic one: "We need to buy Johnny a property now because property values are rising. Johnny is old enough for a property now and we will never get the opportunity again!"

The resurfacing of such an emotionally driven reason to buy a property is a reasonable indicator that market sentiment is getting up there. The top of the current market cycle may be looming. At this stage, emotionally driven buyer transitions have been minimal.

With such a strong southern buyer demand influence last year, potential local buyers knew what price point reflected their highest bid point. This shows that local buyers are doing their homework at this stage of the cycle. They have calculated the price at which they can be profitable and successful. If another buyer out bid them, then so be it.

Should southern buyer demand dissipate in the ensuing months, vendors too will need to be prudent. It may be that in the absence of southern buyers, asking for a price increase on 2018 values may not achieve a successful sale.

In this stage of the market cycle, both, buyers and vendors need to be prudent.

Certainly, with cattle prices looking good and interest rates low, graziers are looking to grow and expand their operations.

Far north Queensland

The general outlook for the 2020 rural market in far north Queensland is best described as cautious optimism.

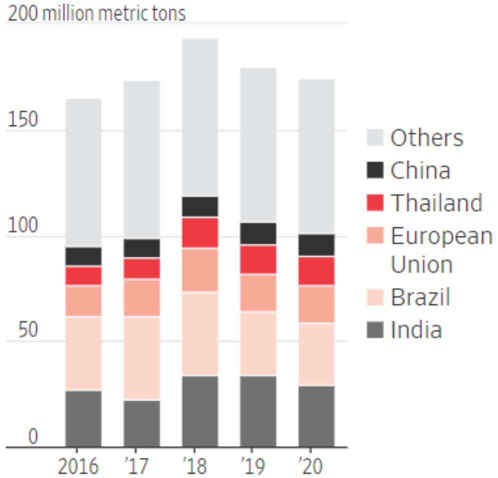
Coastal Horticulture

Sugar commodity prices are forecast to rise throughout 2020 as a consequence of a supply shortfall in Asia.

"Raw-sugar futures rose 1.13 percent to 14.32 cents a pound in New York on Tuesday, extending their advance in 2020 to 6.7 percent. Sugar prices have outstripped other soft-commodity markets so far this year, and have recovered 33 percent since falling to a trough of 10.76 cents a pound in September." "Adverse weather conditions for sugar farmers in India and Thailand—the world's largest and fourth-largest producers respectively last year—have lifted prices in recent months."

Sugar Shortfall

Annual sugar output by major producers



Note: 2020 is a forecast.
Source: U.S. Department of Agriculture

Alternative use industries for coastal horticulture lands may reduce reliance on the traditional industries of sugar cane and bananas. The recent purchase of a large sugar cane farm near Mourilyan, south of Innisfail, may signal the start of a viable alternative use for coastal sugar cane farms. International Biomass Solutions (IBS) has purchased the farm as a test plot for the growing of high protein grasses as a cheaper, alternative protein source.

IBS is engaged in the development, growing and processing of various biomass plant varieties in different parts of the world. With the use of innovative technologies of its partners, the company aims to contribute to energy and industry transformation with the ultimate objective of sustainably reducing carbon dioxide output and increasing farmers' income. IBS works on biomass projects independently or in close cooperation with growers, cooperatives, local or national governments and industrial stakeholders.

The ongoing success of quarantine measures for the banana fungal disease Panama Tropical Race 4 is likely to give greater confidence to the banana industry and growers, particularly in the Tully Valley. Despite the threat of the disease spreading, it has been well contained to a few small outbreaks on two farms. Banana farm sales were limited in 2019, however the success of quarantine measures is likely to lead to more farm transactions in 2020.

NT/Kimberley

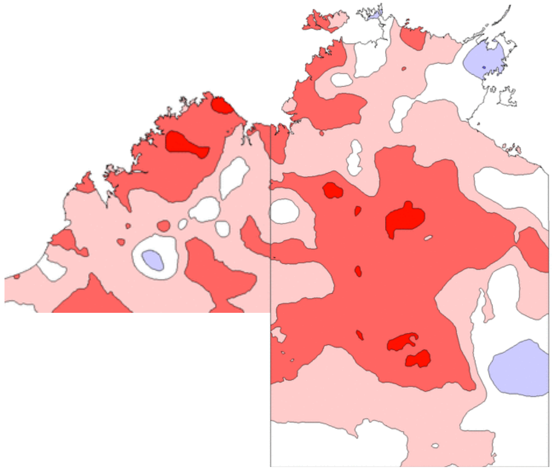
Pastoral

Following a relatively steady year of sales activity in 2019 which included nine station sales (all Perpetual Pastoral Lease holdings: PPLs) with combined WIWO sale price of $131.2 million - or $122.12 million (bare) - and a combined current carrying capacity (at current levels of development) of around 67,300 Adult Equivalents (HTW's estimate). Interestingly, that works out at $1816/AE (bare). Around $50 million of the $131.2 million above comprised two CPC sales ("Ucharonidge" and "Manbulloo") and that the figures also exclude the "Auvergne/Newry/Argyle Downs" deal which went to contract back in January 2019 for around $135 million (WIWO) or $70 million (bare) but which has not yet settled. It also excludes the sales of the two Perpetual Crown Leasehold cattle properties (PCLs generally have superior utility compared to PPLs) including "Carmor Plains" $20 million (WIWO) or $17.9 million (bare) and "Sturt Downs" $7.5 million (WIWO) or around $6.5 million (bare). Add these three deals to the mix (on the basis that the "Auvergne" aggregation actually settles) and total sales for 2019 will stack up to $265 million (WIWI) or $216.73 million (bare). That lifts the $/AE (bare) rate significantly $2925/AE.

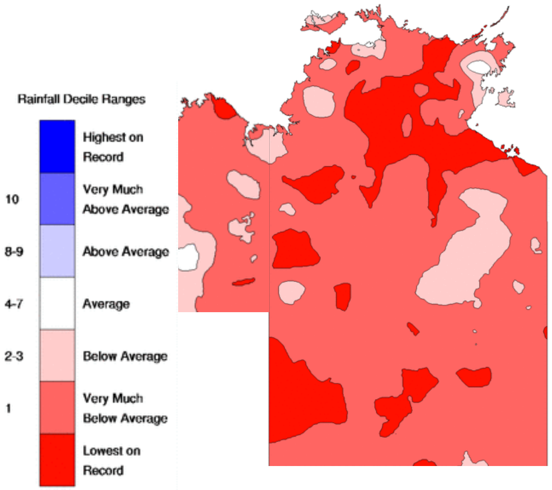
I also note that there were no pastoral sales in the Kimberley during 2019. Overall however, it was a much bigger sales year compared to 2018 which yielded just five sales: $43.37 million (WIWO) or $25.48 million (bare) showing $1405/AE (bare).

As we have mentioned in previous Month In Reviews during 2019, the value rates reflected by the sales ($/AE) vary significantly between similar type properties, due mainly to widely varying opinions of sustainable levels of productive capacity (carrying capacity) and there would appear therefore to be some unjustifiably high value rates because of this. The below average pasture growth that occurred across many NT stations during 2018/19 has highlighted some of these overestimates. With rural property market conditions approaching 12'o'clock in the cycle, now is not the time to be bullish on sustainable carrying capacity estimates, otherwise any negative effect of a property downturn (not saying there is one imminent) will be compounded as the market at that point will be using realistic productivity assessments as a negotiation piece - why wouldn't they? But at this stage the chickens haven't come home to roost for some, and despite the well below average 2018/19 wet season (refer rainfall deciles below) and the poor start to the 2019/20 wet season, the dry times didn't keep the buyers away.

Bureau of Meteorology Wet Season Rainfall Deciles:
1 October to 31 2018 to 30 April 2019



1 October to 31 December 2019



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Halleluiah! The monsoon appears to have finally arrived (mid January, a bit over two months late) and with it the first sales activity for the year with a large-scale aggregation in the northern half of the NT contracting for sale. Full details remain confidential at this stage however the two PPLs (over 5500 square kilometres combined) apparently attracted a reasonable number of competing interests and the sale is expected to form a well tested value benchmark for live export dependant, northern grazing country. Although it's not the traditional selling season (normally during the dry season), pastoral listings in the NT/Kimberley are looking a bit slim with nothing formally advertised for any of the regions apart from the Top End (one station), Sturt Plateau (three stations), Central Plateau (one), Tablelands/Gulf (two) and Alice Springs (one station).

Agriculture

The irrigation land market is picking up over in the East Kimberley (Ord River Irrigation Area or ORIA) with building confidence that GM cotton may be the next mainstay crop of the ORIA, particularly into the 7700-hectare Stage Two (Goomig) expansion area. After three farm sales in the original 15,100-hectare Stage 1 area during 2018 which showed between $10,500 to $11,000 per 'green' hectare (inclusive 17ML/ha pa surface water allocation) there has been another transaction, late in 2019, that confirms such value levels and also confirms the growing belief by farmers from the south-east that cash flow can be underpinned by having irrigation country in the ORIA given its secure water supply. At this stage, the details of the transaction remain confidential, but like two of the three buyers in 2018, this buyer is also from down south and was chasing a large, secure supply of irrigation water.

In the same theme, the Mirriwoong Gajerrong Corporation (MG Corp) who are the second largest landholder in Stage 2 of the ORIA, in its pursuit of commercial agriculture ventures on their land, signed a Memorandum of Understanding (MOU) with cotton giant Cubbie Farming. The organisations will work together to investigate the feasibility of cotton by growing trials on around 290 hectares of leased land in the Goomig area. The first crops will be sown by February (2020) and once harvested, later in the year, will be sent to Cubbie's Dirranbandi-based gin in Queensland 3500km away. If trials are successful MG and Cubbie will consider making a joint application to the Northern Australia Infrastructure Facility to secure federal funding to build a cotton gin in Kununurra.

An industry commissioned feasibility study early in 2019 considered whether a gin, which could cost in excess of $30 million to build, would be financially viable in northern Australia. Cubbie Farming report that "diversification" was the impetus for the MOU which has been under negotiation for the last twelve months following an expression of interest process in 2018. The drought and low to nil allocations and no reservoir supplies back at Dirranbandi, have reportedly encouraged Cubby to search for diversification opportunities. This agreement is further evidence that eastern Australian irrigators (particularly cotton growers) now appear to be more willing to bear the increased risks and costs of farming in more remote locations if the trade-off is simply a far more secure water supply. At present, many of these farmers currently have expensive, high quality irrigation assets back in eastern Australia that have nil water available and therefore have significantly reduced cash flow. Cubby Farming would have considered the known cost of transporting raw cotton from Kununurra to Dirranbandie for ginning, however they have committed to this MOU in order to potentially develop more irrigation country in the ORIA to sure up production.

Cubby will also have been aware of the debate on water reform in the ORIA which has been ongoing now between the Ord Irrigation Cooperative (OIC) and W.A. Department of Water and Environmental Regulation (DWER) now for nearly four years. What is potentially at stake here is a thirty percent reduction in the OICs water entitlement. I note that each irrigator in the ORIA has a shareholding (which equates to their annual entitlement) in Water Services Provider: OIC who control water allocation in the valley. The OIC holds a single, large, surface water licence (SWL) by virtue of the Water Services Licensing Act, subsequently water licences and renewals are at the discretion of the DWER. The SWL is for 335 gigalitre per annum which is ultimately sourced from Lake Argyle, Australia's largest dam (twenty times the volume of Sydney Harbour). The OIC currently distributes its allocation to irrigators through entitlements that equate to 17ML per hectare of their developed farm area. However, the OIC's licence is currently only in place due to a standing injunction which is preventing DWER from enforcing their 2015 decision (at the time of OIC's last licence renewal) to reduce the SWL by around thirty percent back to 246.3 gigalitres per annum. The OIC objected to the

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department's decision and won the injunction to maintain the previous allocation whilst the matter was dealt with under the State Administrative Tribunal (SAT) process. In its decision to order the thirty percent reduction, DWER claimed that since gaining its first water licence, at most, the OIC had used only sixty per cent of its entitlement, down to as little as 42 per cent in some years and that under the SAT process, experts from DWER and the Department of Agriculture had worked together with two independent experts to calculate current and future crop requirements and that the new 246.3 gigalitres would be more than ample.

Our discussions on this matter with the OIC, indicated that there was a possibility that the thirty percent reduction could be imposed if the 2015 decision to enforce the reduction is upheld in the final SAT hearing scheduled for March 2020. This is therefore likely to have the flow-on impact of reducing entitlements to irrigators. However, the most recent negotiations between OIC and DWER at the SAT hearing in Kununurra in December 2019 were reportedly promising from an OIC/entitlement holder's perspective. The case put forward by the OIC is based on a mounting argument that DWER are operating outside logic or good government with a 'use-it-or-lose-it' mentality which is inconsistent with the National Water Initiative (to which WA is a signatory) and also that the current 335GL allocation gave irrigators the necessary flexibility they need to overcome their remote location and the tyrannies of distance by achieving economies of scale given their current ability (with 17ML/ha pa) to interchange between a variety of crops with different water demands depending on market prices. This is the single greatest advantage that farmers in the ORIA have.

In the figures below I have attempted to show the value that buyers of irrigation land in the ORIA appear to be placing on high security water combined with comparatively high allocation rates (compared to the rest of Australia). The dollar per irrigable hectare rate for properties in the ORIA tends to be toward the lower end of sale rates in Queensland due mainly to the higher underlying land values in the Queensland locations, but this is countered to a large extent, by the value the market is currently placing on the much larger and more secure annual water entitlement in the ORIA (subject to the SAT outcome of course!). For example, if the added value of the water entitlement only (ie. water value separated from the underlying land value) is analysed on the basis of a $/hectare rate as well as a ML/hectare basis, then the Queensland sales compared to the ORIA sales show (approximately):

- **Sale 1** (2018, Central Queensland) $7000/ha (water value only) for a 7ML/ha pa entitlement
- **Sale 2** (2018, Central Queensland) $11,000/ha (water value only) for a 6ML/ha pa entitlement
- **Sale 3** (2018, Southern Queensland) $13,300/ha (water value only) for a 11ML/ha pa entitlement
- **Sale 4, 5 & 6** (2019, ORIA, Kununurra, WA) $7,000/ha (water value only) for 17 to 19.4L/ha pa entitlements.

I note that the ORIA sale has significantly superior water security compared to the Queensland sale properties. I will be watching the outcome of the final SAT hearing in March with much interest, as I'm sure will all stakeholders in the far northern Australia farming community.

Please also Note: Unlike Queensland, where we have good evidence for the value of developed dryland cropping country (ie. developed cropping country sitting alongside irrigable country of similar quality, but the former just doesn't have an allocation), there have been virtually no dryland farming sales in the ORIA to accurately determine value of potentially irrigable land. And theoretically, if Lake Argyle and its massive supply never existed, then I guess the Ord Valley would never have been developed. Therefore, we could argue that virtually all of the value in the Ord Valley is in the water and the land really holds very little value, despite its beautiful self-mulching clay characteristics. This would then mean that an irrigation entitlement in the ORIA could potentially be worth close to all of its $10,500 to $11,000/ha. At 17ML/ha this equates to around $630/ML!