PRATT WATER SOLUTIONS

Supplementary Submission

To: House of Representatives Standing Committee on Agriculture, Fisheries and Forestry

Inquiry Into Future Water Supplies for Australia's Rural Industries and Communities

Re: Water Bonds

In previous evidence presented to this Inquiry[1], Pratt Water has proposed the establishment of a government bonds mechanism for financing public water supply infrastructure.

A conceptual water bonds arrangement has been discussed (see attachment) which could be implemented by the Commonwealth Government as *the* primary funding mechanism for significant national water infrastructure investment.

Governance of the financing mechanism could be through a Water Bond Vehicle (WBV), which would need to be established to control and manage proceeds from the sale of Water Bonds to investors. The WBV would award and supervise contracts for appropriate infrastructure developments (including new pipelines), and could also provide long-term finance to farm and regional organisations for approved projects. Bond finance may also be allocated to qualifying urban water infrastructure projects, if that accords with government policy and demonstrated need.

Some questions and answers relating to the potential operation of the water bond financing system are set out at the end of this submission.

The Committee has requested summary information on the potential Government financial outlays that may be involved in a "typical" water bond arrangement, based on a total infrastructure financing task of $10 billion.

In summary:

- Bonds issued by Commonwealth @ $1bn/year for 10 years = $10bn capital
- Capital plus (say) 6.0% interest guaranteed by Government
- Interest outlay is $60m/year from Year 2 = $0.6bn over 10 years
- Acceptance criteria for financed projects set at, say, 1.5% above bond interest rate (i.e. 7.5% min. return)
- Capital repayment terms are "principal only", after 10 years
- Bonds may be "rolled over" for further 10 years by investors.

[1] See:
(a) Submission by Richard Pratt AC – Submission No. 4 – 30 July 2002, and
(b) Transcript of evidence – Monday 7 April, 2003

Water Bonds – Q & A

1 Who will own water infrastructure funded through Water Bonds?

The Water Bonds will be managed through a structure "Water Bonds Vehicle" (WBV) which may ultimately be a Federal/State body. Key functions of this vehicle are:

- Management of funds raised by Water Bond issue
- Award and overview water infrastructure contacts/projects
- Progressively control water access entitlements including purchase/sale, security pricing and legal framework
- Provide long-term finance for on farm improvements of irrigation systems and regional water treatment development.
- Set pricing levels for recurring annual water transport charges
- Overview the operations of the new or redeveloped water infrastructure in collaboration with regional stakeholders

2 How would the farmer benefit from such infrastructure?

Firstly, the redevelopment of existing water infrastructure should progressively deliver greater certainty to the farmer regarding receiving their water entitlements each year. In addition to this if the farmer takes advantage of long-term finance offered by the WBV further on farm water savings can be achieved. This may result in the farmer having surplus water entitlements, which may be purchased by the WBV for resale. Alternatively, the farmer may utilise additional water to switch to higher value crops, consistent with the availability of appropriate markets for such products.

In summary, the farmers' security will be enhanced, providing greater opportunities for increasing the farm operation's gross margins

3 How would the investor get his money (+profit) back?

The investor would subscribe to a Federal Government backed Water Bond issue for a specified term and maturity date. If the term is in excess of 10 years there may be an interest rate adjustment mechanism to reflect prevailing market conditions. The investor will be paid interest on the Water Bonds, either quarterly or half yearly by the Government.

The investor returns are not dependent on the profitability of the water infrastructure investments. The Government will fund interest payments from Consolidated Revenue. Therefore the investor has no risk regarding returns and the Government repays the Water Bonds at maturity at the face value of the bond.

4 Can the Water Bonds be traded?

Water Bonds should be able to be traded in a similar manner as Commonwealth Bonds, Government and Semi-Government Bonds. .

5 Could such infrastructure be bought and sold?

The redeveloped and new water infrastructure will be owned by the WBV. One issue that would need to be resolved would be the relationship between water infrastructure held by the WBV and title to existing water infrastructure, particularly where these existing assets formed part of any redevelopment project. Rules setting out this relationship will need to be detailed in the WBV charter. The value of assets transferred may be in kind rather than cash, i.e. the States' contribution to the projects.

Any water savings from new infrastructure would be owned by the WBV and could be reallocated via agreed market mechanisms to (a) the government for environmental purposes and (b) other primary producers for regional development.

In the case of long term finance provided by the WBV to farmers and regional organisations, the assets acquired would remain the property of the financed body, but any surplus water savings would be allocated by the WBV according to agreed rules.

6 How will the Water Bonds Vehicle be structured?

The WBV will require to be supported by Federal legislation, which would be mirrored by those participating States. Decisions on the nature of the vehicle's corporate status would be made following consultation with the stakeholder groups.

Governance of the WBV will be defined in its charter, backed by appropriate legislation.

The WBV will progressively assume operational responsibility as its projects are commissioned. This will also apply to management, monitoring and review. This will require close consultation with stakeholders. This approach does not necessarily prevent the WBV from outsourcing functions, provided the charter and legislation gives the appropriate authority.

7 Describe an hypothetical infrastructure project that is funded by the bond mechanism, including money flows?

Water In The Murrumbidgee Valley (Pratt Water, 2002) describes a range of existing project within the Region which have been awaiting financing, some for many years. Following agreed criteria, one or more of these projects could be selected for funding by water bond finance through the WBV.

Assume these projects will cost $250 million and take two years to complete and commission.

The following steps would occur:

(a) Federal Treasury will issue say two tranches of Water Bonds of $125 million each in years one and two

(b) The proceeds of the Water Bonds will be held and managed by the WBV.

(c) The WBV will approve the proposed water infrastructure project and then seek tenders and accredit suppliers, award contracts and manage the works. Activities such as engineering, design and project management could be outsourced.

(d) The WBV will make payments to contractors and suppliers after the project manager has certified progress. This process will continue until the project is completed and accepted.

(e) The Water Bond investors will be paid interest (as it falls due) by the Federal Government and the Federal Government will repay the bonds at face value at maturity.

On completion, the WBV will manage this infrastructure, buy and sell saved water, set pricing for water transport and manage the operations in collaboration with the region's stakeholders.

..../ Water Bonds schematic

Water Bonds - Schematic Representation