

The Murray-Darling Basin Balanced Water Fund

APRIL 2019

AUM: A\$51.7M

UNIT PRICE A\$1.66

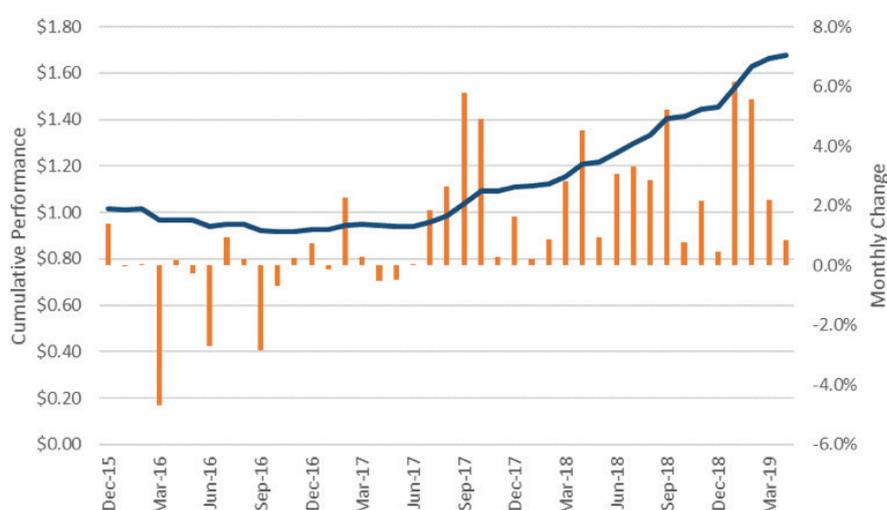
A return of 0.83% for the Murray-Darling Basin Balanced Water Fund (BWF) in April is contributing to a strong financial year-to-date result of 33.5%.

BWF benefited from increases in valuation for both high-security water entitlement and water allocation. Small volumes of remaining allocation holdings will continue to be progressively sold to the end of the financial year.

The water allocation market continues to be supported at high levels but with heightened volatility. Trading volumes have been thin and irrigator concern about supply for next year saw the price spike to more than \$600 per megalitre (ML) as buyers entered the market to carryover for next year. Recent rainfall impacted sentiment and prices quickly receded despite no meaningful increase in storage inflows.

Storage levels across the southern Murray-Darling Basin (sMDB) dropped 2.1% to 33.9% of capacity, which is within 1% of the lowest storage levels since April 2010.

Monthly Returns



The Bureau of Meteorology's three-month outlook (May to July) is forecasting average rainfall conditions across the sMDB. Its climate

model suggests a short-lived El Niño may develop, which would increase the chances of drier conditions across Eastern Australia.

Summary Data (net)

Month return (%)	0.83
Last three months return (%)	8.79
Financial year return (%)	33.51
Rolling 12 months (%)	38.90
Performance since inception (%)	67.67
Since inception ANNUALISED [p.a.] (%)	16.66

Fund Information

Name	The Murray-Darling Basin Balanced Water Fund
Structure	Unit Trust
Domicile	Australia
Inception	October 2015
Management Fee	0.55% per annum
Trustee Fee	0.15% per annum
Performance Fee	15% per annum
Hurdle Rate	6%
High Water Mark	Yes
Minimum investment	A\$100,000
Administrator	Apex Funds Services Ltd
Auditor	Ernst & Young
Sponsor	The Nature Conservancy Australia
Custodian	Sandhurst Trustees Ltd
Legal Advisor	McMahon Clarke

Contact Information

Fund Manager

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The Market

What is driving strong growth?

Irrigation region	Entitlement class	Valuation growth since July 2017
Vic Goulburn	High reliability	50.5%
Vic Murray (Zone 7)	High reliability	78.0%
NSW Murray (Zone 11)	High security	71.4%
NSW Murrumbidgee	High security	74.6%
SA Murray	High security (Class 3)	84.1%

Table 1: Selected sMDB water entitlement valuation growth since July 2017. Source: Aither

Strong economic forces have been driving significant gains in water entitlement valuation for BWF's key entitlement classes in the past 22 months. Table 1 summarises this uplift, as provided by the fund's independent valuer.

At the forefront is the finite volume of water entitlement on issue. While an increase in price may bring more sellers to the market, unlike other assets or commodities, it cannot stimulate additional supply.

Secondly, water has no substitute and without water there is no irrigated production. If a farmer doesn't own sufficient entitlement to generate the required allocation, they either have to purchase additional water or acquire more entitlement. With water allocation trading at between \$400/ML and \$600/ML for much of the season operators may decide it is a cheaper and better long-term option to buy water entitlement. Many farmers are currently able to borrow at interest rates of 5% p.a. or less. If they were to purchase Vic Murray (zone 7) Water Entitlement at \$5500/ML, the resultant annual interest cost of \$275/ML is substantially less than the cost of acquiring the same volume of water allocation in the market today.

The level of reliability for receiving allocation is a strong driver of demand and appreciation in value. While high-reliability and high-security water entitlement classes have significantly appreciated, NSW general security, which this year received 0% allocation in Murray and only 7% in Murrumbidgee, has recently seen depreciation in value. The capacity of the entitlement class to trade its allocation to where demand is highest also influences valuation.

The drivers of the water allocation market, which in turn strongly influence the water entitlement market, are supply and demand. The supply of water allocation in the sMDB has been falling due to the long-term trend of declining winter rainfall and a resultant drop in storage inflows.

Kilter Rural's analysis of rainfall trends at the five major sMDB storages (see Figure 1) shows a 26% reduction in the winter rainfall trend line in the past 40 years. Winter rainfall is critical to saturate soils, generate streamflow and water storage inflows. According to a 2006 report from the *Hydrological Sciences Journal*, a 1% reduction in rainfall can lead to a 2 to 3.5% reduction in streamflow.



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The Nature Conservancy

An additional factor influencing the supply of water has been the recovery of water from irrigators to be returned to the environment under the Murray-Darling Basin Plan (Plan). Since 2008 the volume of consumptive water available in the sMDB has been reduced by about 25% through implementation of the Plan. The Plan will continue to be a factor in reducing supply going forward. In the lead up to the current Federal election both of Australia's major political parties have committed to implementation of the final stage of the Plan by 2024. This will require the recovery of a further 450GL, a volume equivalent to about 10% of supply in the current season.

Also, increases in plantings of high-value permanent horticulture and viticulture within the sMDB is changing demand for water allocation. According to the *2018 Mallee Horticulture Crop Report*, the irrigation area within the catchment doubled from 40,325 to 81,150Ha between 1997 and 2018. New almond plantings increased by 10,661Ha between 2014 and 2018, states the *2017-18 Almond Insights* annual report, which will require up to 140GL per year once the trees mature. This will come at the expense of existing users. High-value permanent crops require significant investment to establish and almond orchards have an economic life in the order of 25 to 30 years. As a result, very high water prices can be justified in order to protect the value of the investment.

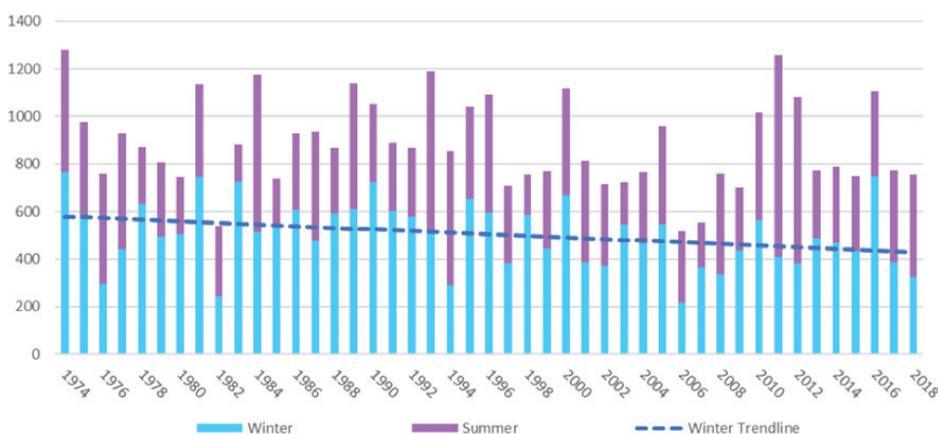


Figure 1: Average annual rainfall (mm) for sMDB major catchments.



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Strategy

The Murray-Darling Basin Balanced Water Fund invests in permanent water rights in the southern Murray-Darling Basin. It provides the first opportunity in Australia to achieve the multiple objectives of securing water for agriculture, realising a financial return and restoring threatened wetlands through a single investment.

Manager Background

Kilter Pty Ltd (trading as Kilter Rural) was founded in 2004, with Kilter Investments Pty Ltd a wholly owned subsidiary. Kilter Rural's purpose is to build long-term value for investors through resilient farmland and water investments. It is one of Australia's largest water fund managers with more than \$330 million of water assets and \$400 million of real assets under management.

Monthly Performance %

(net of fees and expenses)

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2019	6.16	5.59	2.18	0.83									15.48
2018	0.23	0.86	2.83	4.52	0.93	3.08	3.30	2.86	5.21	0.76	2.16	0.46	30.69
2017	-0.14	2.28	0.29	-0.51	-0.47	0.04	1.86	2.66	5.77	4.90	0.28	1.63	19.98
2016	-0.04	0.03	-4.70	0.17	-0.26	-2.71	0.96	0.21	-2.83	-0.69	0.24	0.75	-8.69
2015												1.41	1.41

Disclaimer

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