BEFORE THE COMMISSIONERS APPOINTED ON BEHALF OF OTAGO REGIONAL COUNCIL

RM20.003, RM20.005
and RM20.007

IN THE MATTER	of an application for resource consent
BETWEEN	**ROCKBURN WINES LIMITED**
	PISA HOLDINGS LIMITED
	SMALLBURN LIMITED
	Appellant

BRIEF OF EVIDENCE OF HAYDEN TEMPLETON CRAW

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BRIEF OF EVIDENCE OF HAYDEN TEMPLETON CRAW

1. My full name is Hayden Templeton Craw. I am an Agribusiness Specialist with Compass Agribusiness Management Limited.

2. Compass Agribusiness Management Limited is a privately-owned company that provides agricultural and rural business consultancy. Located in Otago, New Zealand as well as Victoria, Australia, I provide advice to clients throughout the South Island of New Zealand as well as in Victoria, Tasmania and New South Wales in Australia. We have acted in advisory roles for the Manuherikia and NOIC irrigation schemes and provide consultancy work for many large-scale irrigated farms throughout the South Island. I have many customers in the Central Otago region including several in the Tarras / Lindis catchment.

3. My services include a full range of farm consultancy and advisory services as well as planning and business management. I also assist large scale commercial and family farming entities with financial management. I have been working with farmer providing this type of advice for over 12 years. I have also worked on farms as a young person and during travel overseas to the UK.

4. I hold a Bachelor of Applied Science, majoring in Agriculture and Agribusiness from Massey University.

5. I confirm that I have read and agree to comply with the Environment Court Practice Note 2014 with regard to Expert Witnesses. This evidence is within my area of expertise, except where I state that I am relying on what I have been told by another person. I have not omitted to consider material facts known to me that might alter or detract from the opinions that I express.

Scope of evidence

6. The purpose of this evidence is to outline the importance of access to water for horticultural and pastoral businesses in Central Otago and to summarise what impact the length of consent to access water for irrigation has on the investment decisions and the implications that it has on the resultant financing application.

Executive Summary

7. Water, in a broad context, is the most important resource in Central Otago to derive production out of land, regardless of its classification. In the Cromwell basin and Upper Clutha areas, access to water has driven significant investment, with the expansion of viticulture and more recently cherry orchards. I am also aware of a number of cherry developments pending.

8. In many cases the land was previously plagued with rabbits and weeds. Essentially, the costs of managing these pests outweighing the productive capacity of dryland land use options. Access to water changes that. For example, undeveloped land on Bendigo Station has c commanded prices circa. $40,000 / hectare on the condition that enough water is available for an extended period.

9. From a pastoral perspective the same can also be said, with once dryland flat and hill country blocks now being farmed as intensive finishing units achieving results comparable to other areas regarded as having more “productive” type land, such as Canterbury.

10. Water infrastructure has also catalysed investigations in too the opportunities that relatively new to the area. Such as, carrot seeds and other high value small seed crops. This demonstrates what effect “reliable” water can have on productive capability.

11. The majority of clients that Compass Agribusiness, either consults to or manages assets on behalf of, have lifted their productive capability with the introduction of water.

12. The resultant productivity is the key driver of the value of the asset. If there is any uncertainty around current or future productivity, this uncertainty is directly reflected in value people are prepared to pay for the asset. We are seeing this in areas such as the Manuherikia valley where uncertainty around water derived from the Falls Dam and deemed permits replacements has had a significant negative impact on perceived saleability and value of land in that area.

13. Water is a precious resource and is now being managed and regulated as such. Renewing existing consents and permits is not guaranteed and any increase in existing takes is proving extremely difficult if not impossible to gain approval for. Therefore, the term of the water consents is significant.

Financial Assessment

14. Banks undertake a comprehensive risk review when looking at a financing request. Many factors are taken into consideration, but assuming qualitative risk factors such as management, markets and compliance are met, approval and loan terms become dependent on key quantitative criteria being cashflow, security and equity.

Cashflow

15. Cashflow is an assessment on the ability of the business to meet its commitments, taking into consideration its income and expenses. Productivity drives cashflow. When assessing business lending, banks are confirming that they are comfortable with the assumptions made around:

    (a) ability for the business to meet its operating commitments and,

    (b) ability for the business to repay the principal amount of the loan over a designated period.

16. This designated period, takes into consideration any likely changes that would impact on the continued productivity of the business, in this case the term of the water consent which relates to the access to water. Without access to water the productivity of these businesses relative to current performance is minimal.

17. With irrigation development, it is generally 5 years before any acceptable return is generated. This aligns with when the cherry trees and grape vines approach an acceptable yield (but not full yield) and in our experience, when pastoral farms develop irrigation, it takes at least 5 years to achieve the full productive capability of the pasture.

18. This is important as under normal circumstances the first 5 years post development provide limited ability for business to undertake the required principal reduction, therefore the principal reduction required over the remaining term of the loan increases.

19. Significant investment has been made into the many of the properties subject to these applications. Cherry orchards have invested upwards of $150,000 per hectare and the pastoral based farmers, in the vicinity of $7,000-$10,000 per hectare. The investments made, whilst I haven't viewed each farm independently, appear to have been completed with a long-term view considering the quality and type of infrastructure that has been invested in.

20. Whilst the gap in required investment in the land is significant, it does align with the average yield returns for each class, with horticulture assessed as 12-25% yield, viticulture 12-18% yield and pastoral faring 2.5-4.5% yield return.

21. Cashflows are stress tested to take into consideration the variability of the business operation, in particular the vagaries of the weather. The unpredictable operating environment, particularly in horticulture, creates significant swings between seasons and businesses need to be robust to handle this. Banks often look to ratios like interest cover when assessing cashflow. When the perceived risk is higher, the interest cover ratio under average efficient performance is required to be higher.

Security

22. A security is an interest or a right in property given to the creditor to convert it into cash in case the debtor fails to meet the principal and interest on loan. When lending to primary industries, the main form of security is provided by way of mortgage taken over the land holding. Financiers require external independence around the value of assets they take security over, and often instruct registered valuers to undertake this on their behalf. The value of the asset is then scaled which provides an available lending value, essentially the loan to value ratio.

Valuations

23. The primary industry land market has seen a significant shift from a capital-based market to a returns-based market where the focus is on cashflow profitability. The returns-based method establishes estimated cashflows of the investment divided by a required return to establish current value.

24. When uncertainty exists, a higher return is required to offset this risk. In general, the current market is requiring improved returns from historical levels, with the requirement being driven by increased uncertainty around consenting and compliance, rather than product prices and borrowing costs as both are at very good levels relative to historical levels.

25. To achieve greater returns, the purchaser essentially needs to buy the property at a lower value. Important to consider alongside this, particularly in the current environment, is the weight of capital, with increased scale and an increase in committed capital having a higher cost overlay, so larger investments are requiring a larger return.

26. The valuation approach when considering pending water consent expiry, has not been to write off the value of the asset at the expiration of the loan term, but more to take a hedged approach in understanding the wider area / zone, allocation of the zone, current ecological standards etc to understand the likelihood of renewal and also the ability to continue to achieve productive output at an acceptable level.

27. Where issues are seen around future productivity, markets essentially freeze which is the case in the Waimakariri zone in Canterbury, where sinking lids on nutrient loading has reduced the future ability for productive output and this uncertainty has removed any liquidity in the market.

28. Currently in Otago the issue is uncertainty which has been created by the change in approach by the Otago Regional Council. At this point this has not resulted in a market freeze, but it is a matter that is being observed very closely and extra precautions being taken.

Equity

29. Assets – Liabilities = Equity. The higher the perceived risk, the higher the external equity the bank requires to reduce the likelihood of loss from a bank perspective. The appropriate level of debt and therefore equity for a business is intrinsically linked to cashflow and the ability to service the debt and supported by the realisable value of the assets.

30. When considering the above factors, what potential impact does a shorter water consent term have on gaining finance?

    (a) Reduced level of access to funding and ingoing debt level, and as a result, increased requirement from shareholders to introduce capital to support development. This would be seen in higher expected interest cover ratios.

    (b) A changed balance between profitability and liquidity, with liquidity (cash or assets readily realisable) and use of this cash to repay debt more of a focus when terms are shorter.

    (c) This negatively impacts on the businesses ability to reinvest which often means cheaper alternatives are looked at – for example k-line irrigation versus fixed grid irrigation as the initial capital outlay is around 30%, but this comes at the expense of water use efficiency and additional wage cost.

    (d) Increased principal repayment requirements over the term of the loan and less flexibility to support seasonality.

        (i) This is often offset by the reduced initial proposed bank debt level as banks want to support businesses to perform to their maximum potential and allow for the known volatility in farming business.

    (e) The shorter the term of the water consent, the more uncertainty around future production and therefore the assessed value of the business reduces.

(i) This impacts the available security. Less available security relative to the loan amount increases risk from a bank perspective. Higher risk = higher cost of funding.

(f) A shorter term will restrict the ability to access capital to develop more land or to restructure existing land to react to changing market conditions or demand.

(i) This is important as markets and clients evolve over time, so businesses need the ability to be able to mirror this and adapt.

31. Each bank has their own criteria when assessing these and they change depending on their exposure and desired exposure to the industry. Banks retain the right to review the terms of the loans at any stage if loan conditions are not met, therefore it is important to note that length of water consent term does not guarantee continued funding.

Conclusion

32. Water is the most important resource in Central Otago to derive production out of land. The reliability of this production and the confidence around this production being achievable over time is the key investment decision when looking at any development associated with irrigation.

33. The significant investment made to date on the associated properties has been done to an above average level, to ensure efficient use of water and to create confidence in the business going forwards.

34. The impact of a short consent period of 15 years, is that it creates uncertainty around productivity into the future and this uncertainty requires anyone investing, whether it be a shareholder or a financier, to require additional comfort, whether it be a higher yield for an investor or higher interest rates from a bank perspective. In the case of these applicants many have completed investment with expectations that in doing so they would achieve long term renewal. A sudden change in

this that reduces certainty will have a flow on impact as I have described above.

35. A longer renewal term of 25 years plus will minimise the uncertainty over the current investment horizon ensuring an appropriate return can be achieved from the existing investments. It will also allow continued investment to support improvement in efficiency over time and respond to market variability as necessary.

Hayden Craw

Agribusiness Specialist

27 August 2020