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HD **Funds Dip Toes Into Australian Water**

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SYDNEY -- Australian fund managers are eying an increasingly liquid market: water.

A state-run system giving farmers fixed allocations for river water flowing into the country's agricultural heartland is tempting speculators to **buy** up those rights in anticipation of higher prices.

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A specialist fund manager, Blue Sky Alternative Investments Ltd., recently raised 20 **million** Australian dollars (US$18 **million**) to pour into the fledgling market, following earlier moves by San Diego, Calif.-based Summit Global and VicSuper, one of Australia's biggest pension funds.

According to Australian government estimates, the water rights are worth A$26 **billion**, although only a fraction are traded. Farmers use most of their entitlements to irrigate land on which they grow everything from macadamia nuts to cotton.

Investors globally have long studied the potential of buying into water as an alternative to commodities such as wheat or oil, as shifts such as population growth and urbanization strain supplies.

According to the World Economic Forum, an organization that hosts **business** leaders in the Swiss resort of Davos each year, demand for water globally for individual and industrial use will exceed supply by 40% in 2030.

However, technical limitations have constrained the more advanced use of derivatives and other tools for managing risks and pricing in the water market. Small-scale trading of water occurs in some U.S. states, such as Arizona, but no comprehensive platform for open dealing exists.

Adding to the challenge is the perception that water is abundantly available.

Moving water can be expensive, either to places experiencing drought, or between buyers and sellers that aren't located close together. Also, putting a price on water is politically unacceptable in many countries, where access to lakes and rivers is considered a basic right.

As a result, investors have largely chosen to bet on infrastructure and technology linked to water production, transport and storage.

Two years ago, **China** Investment Corp., that country's sovereign-wealth fund, acquired 8.7% of Thames Water, a closely held utility responsible for the public water supply in London. Another U.K. water provider, Severn Trent PLC, rejected a GBP 5.3 **billion** (US$8.8 **billion**) takeover bid by a consortium of British, Kuwaiti and Canadian infrastructure investors last year.

For many investors, Australia's water-trading system is the most advanced. Since 2007, people have no longer needed to own land in the Murray Darling basin -- a vast system of interconnected rivers and tributaries in eastern Australia that feeds the country's major food bowl -- to be eligible to **buy** and sell water rights.

Water in the Murray-Darling basin is allocated to landholders who can either use it on their property or offer it for sale. The federal government decides how much water can be removed, based on rainfall levels.

The government is also an active trader, seeking to guard against too much river water being extracted and causing environmental damage.

Currently, there are nearly 16,300 gigaliters of water in the Murray-Darling basin -- roughly equivalent to 33 times the water contained in Sydney Harbor. The price of an entitlement in the basin ranges from A$900 to A$1,800 a megaliter, according to Australian government data.

"It is a lot easier and more transparent to invest in water in Australia" than in other countries, said Kim Morison, managing director of Blue Sky.

The Brisbane-based asset manager's recent fundraising comes after it invested around A$80 **million** on behalf of Summit Global between 2008 and 2011.

As the world's driest inhabited continent, Australia is prone to droughts, which Blue Sky is betting will boost returns from water relative to other asset classes such as equities.

Blue Sky believes it can generate a net return, after management fees, of 10% a year over a five-to-seven year holding period. Returns are based on a combination of any capital appreciation in the value of the water entitlements it invests in, and the yield that is generated from selling annual water allocations to buyers such as farmers.

By far the largest third-party investor in the Murray Darling basin is VicSuper, a Melbourne-based pension fund that manages around A$10 **billion** in assets.

Another player is Melbourne-based Tandou Ltd., which currently has around A$30 **million** in water entitlements.

"Agricultural investment is a growing area and water is a key part of that," said Oscar Fabian, VicSuper's chief investment officer.

Still, VicSuper's returns on investment in water have been volatile, partly because of the lack of a single national exchange in Australia. Periods of extreme weather, particularly heavy rainfall, have magnified the risks.

For many institutional investors, the potential dangers remain too great. Tyndall Investment Management Ltd., the local subsidiary of Tokyo-based Nikko Asset Management, attempted to raise A$100 **million** from Australian and overseas investors for a water-focused fund last year. It abandoned those plans as big investors shied away from an investment without a proven record of returns.

"I don't want to gild the lily and tell you there is **billions** of dollars of investment capital ready to flood the Australian water market overnight," said Richard Lourey, who led that fundraising effort before leaving Tyndall in September.

Still, intensifying deal activity in Australian agricultural assets, including a three-way takeover tussle for Warrnambool **Cheese** and **Butter** Factory Co. and Archer Daniels Midland Co.'s failed A$3 **billion** bid for GrainCorp Ltd., is helping to change attitudes to water as an investment, Mr. Lourey said.

Australia exports about 70% of its food output, making it a critical supplier of meat and **dairy** goods to markets such as **China**. As incomes in North Asia rise, people will likely rely more on Australia's food bowl and an efficient use of water, he said.

"I can certainly see A$2 **billion** of third-party capital coming into the market over the next five years," Mr. Lourey said.

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