

**Mareeba-Dimbulah Irrigation
Scheme LMA Investigation Board**

Updated Business Proposal Summary



The Investigation Board for the Mareeba-Dimbulah channel scheme has prepared a Business Proposal recommending to government that the scheme proceeds to local ownership and management.

Building on previous work completed in 2014 and following a detailed analysis of the options, the Business Proposal has the support of key stakeholders and is recommended by the Board as a sustainable and financially viable option that will benefit both irrigators and government.

This summary, prepared by the Investigation Board outlines the main features of the Business Proposal.

BACKGROUND AND PROCESS

In July 2012 the Queensland government responded to calls from irrigators to move to local management and set up a working party to determine the level of interest in transferring assets of the eight irrigation schemes, currently managed by Brisbane-based government owned corporation SunWater, to irrigator-owned and managed entities.

In October 2012 the working group's report, Local Management Arrangements (LMA) Working Group Final Report, found broad support for locally managed schemes among irrigators and SunWater, prompting the Queensland government to invite the eight schemes to submit business proposals on how local management could be achieved.

Interim Boards were formed and in 2014 Mareeba-Dimbulah submitted a business case to government, demonstrating how the scheme could be managed and operated by local scheme irrigators over the long-term.

In December 2016 the government established the Mareeba-Dimbulah Investigation Board to further examine and update the original Business case. Our Investigation Board has considered feedback from the government, reviewed the engineering due diligence of the assets including pipeline replacement, updated the financial model and related projections and re-evaluated capital

works for the scheme.

A Reference Group was established to liaise closely with key stakeholders and ensure we considered potential risks and benefits of local management.

The Business Proposal, to be submitted to government on 30 November 2017, will form the basis of the government's decision on whether Mareeba-Dimbulah will be offered the opportunity to transition to local management.

If government decides to proceed with local management for the Mareeba-Dimbulah Distribution Scheme, it will establish a transition company and related Board to negotiate the terms of that agreement on behalf of irrigators. If and when agreement is reached, the government will issue an offer to all those with a water allocation in the scheme, asking them if they support the proposal to move to local management and if they wish to become members of the new company. At that time, irrigators representing the majority of water allocations in the scheme will need to accept the offer for local management to proceed.



OUR BUSINESS PROPOSAL

The Business Proposal has been prepared following feedback from the government on the 2014 Business Case and includes engineering due diligence, detailed analysis of asset management including pipeline replacement, pricing options, operational costs, financial projections for 30 years, taxation advice and consultation with irrigators and the community.

OUR NAME AND VISION

Tinaroo Water Ltd

Managing the Mareeba-Dimbulah Irrigation System to ensure the long-term viability of the scheme for its customers

Why move to local management?

Local ownership means decisions about your scheme will be made entirely in the best interests of Tinaroo Water Ltd and its members. Local ownership will bring a focus on opportunities for local benefits such as:

- ▶ A locally staffed office will serve irrigation customers and co-ordinate water transfers (more in-touch with and responsive to local issues)
- ▶ Ownership and management of the channels, with assets transferred at zero cost
- ▶ Money paid by water users as channel water charges will be used to maintain the Mareeba-Dimbulah scheme
- ▶ A government separation payment to be used to support the not-for-profit-local company's financial viability into the future
- ▶ Decisions about scheme assets, operations and channel water prices to be made locally, not in Brisbane.

The Objectives

The objectives of the locally-owned and managed Mareeba-Dimbulah Distribution business are to:

- ▶ Deliver affordable water with greater certainty around long term distribution water charges
- ▶ Operate a reliable scheme with service standards that reflect customer requirements
- ▶ Ensure long term viability of the scheme and its support of irrigators
- ▶ Increase efficiency
- ▶ Value-add
- ▶ Support regional economic growth
- ▶ Support the community.

Key Strategies to deliver the objectives are to:

- ▶ Identify and deliver cost efficiencies whilst maintaining acceptable levels of service
- ▶ Ensure the entity is sustainable, now and into the future
- ▶ Build and maintain a consensus amongst customers
- ▶ Contribute to the development of the regional community
- ▶ Manage risk and protect the entity from the consequences of unpredictable events.

Corporate Form

Tinaroo Water Ltd will be a company limited by guarantee. Ownership will be based on membership rather than shares, with membership risk capped at \$100 per member (in the event of insolvency, members could be required to pay \$100). Memberships cannot be traded but will be cancelled on permanent transfer of water entitlements and issued to new permanent water entitlement holders who wish to become members. As a not-for-profit entity, the company would not pay dividends or make distributions to customers. All profits would be retained for the benefit of the business and its customers.

Membership

Membership will be issued to channel irrigation customers based on water entitlement from the Mareeba-Dimbulah Distribution System. Seven different classes of membership are proposed (see below). Multiple water entitlements in the same name will be grouped under a single membership.

Voting

To ensure that the primary focus of Tinaroo Water Ltd remains on commercial irrigation, membership will be established in classes according to the size of the licensed allocation held. The Investigation Board has considered various voting structure options to spread the voting power of members across different groups of members, to ensure no single individual or group of members dominates the decision-making process and has sole control of the irrigation channel and its operations. The recommended groupings are captured in the table below. These may be refined further in the next phase based on further member input to align them more closely to changing water allocations. This may include a formula in the Constitution to ensure a fair and equitable voting structure.

To protect the interests of non-voting members, Board members will be assigned responsibility for engaging with non-voting members and ensuring issues relevant to those customers are brought to the Board's attention.

Membership will be voluntary, and will remain open to those who hold an allocation that is supplied by the scheme. Important decisions that may change the future structure, finances, or assets of the scheme will be reserved for decision by members and require a 75% majority vote.

Directors

There will be a skills-based Board of five directors made up of three irrigator representatives and two independent directors. Directors will be appointed by the members at the AGM, and the Directors will appoint the Chair. Directors will retire on a rotational basis. Retiring Directors may be considered by the selection committee for reappointment by members. Initially two Directors will have a one-year term, two will be appointed for two years, and one for three years. After the initial term, Directors will be appointed for 3 years.

Assets and Functions

Tinaroo Water Ltd will own and be responsible for operations, maintenance and refurbishment of all distribution system assets associated with delivering water via the existing network of channels, pipelines, pump stations, supplemented streams, balancing storages and weirs to the entire scheme (excluding the Barron River). Local SunWater staff who work on the Irrigation Distribution Network will be transferred to Tinaroo Water Ltd on their current employment terms and conditions. Those conditions will be preserved for a three-year period after transfer.

Class of membership based on Water Allocation	Number of Members ¹	Votes per Member	Total Votes	% of Total Votes
Z 0 to 2 ML	147	0	0	0.0%
A 3 to 55 ML	408	1	408	16.3%
B 56 to 140 ML	208	2	416	16.7%
C 141 to 260 ML	104	4	416	16.7%
D 261 to 485 ML	53	8	424	17.0%
E 486 – 1150 ML	26	16	416	16.7%
F 1151 + ML	13	32	416	16.7%
Total	959	-	2496	100%

Finance and Pricing

From a cost perspective, we have examined SunWater's local operating costs as well as SunWater's centralised costs and head office overhead and based our financial modelling on our assessment of the costs involved in running the scheme locally. While cost data is still being developed, the Board expects that LMA can run the scheme cheaper than SunWater.

¹ Number of members based on water allocations held as at November 2016

Consulting Engineers Jacobs have completed an Engineering Due Diligence which reviewed and provided independent advice on the long-term asset maintenance and renewals expenditure required. The Board is seeking a separation payment sufficient to allow for delivery of that refurbishment program with a focus on addressing key risks.

From a revenue (water pricing) perspective, the financial modelling undertaken by the Investigation Board assumes that water prices will remain the same for the remainder of the current price path. After that (from 30 June 2019) the model assumes a fixed distribution pricing increases of \$2² plus CPI over 10 years and then rise to reflect inflation only. The LMA price provides revenue to allow for pipe renewal to be brought forward. Based on current government pricing policy, the Board is of the view that in comparison prices under SunWater will rise at \$2 CPI until 2036.

Under local management revenue will no longer contribute to SunWater's corporate overheads and will be retained by local entity.

Financial modelling conducted by the Board identified that a reasonable and justifiable separation payment is required to support the financial viability of the company. The amount of separation payment requested resulted from a rigorous process and, based on the assumptions made, should be sufficient for the company to operate, maintain and refurbish the scheme.

The Board's proposal is subject to reaching a satisfactory position with Government in relation to a number of factors, including:

- ▶ Amount of separation payment
- ▶ Channel Water Weed Control
- ▶ Future Bulk Water Pricing
- ▶ Sufficient Working Capital at commencement
- ▶ Transaction costs funded, over and above separation payment.

The government has stated that the assets of the scheme will be transferred from SunWater to Tinaroo Water Ltd at no cost in the event that government and irrigators ultimately support such an initiative. Consistent with the engineering due diligence

undertaken on key scheme assets, our Business Proposal recognises that there are some significant asset expenditure requirements facing Tinaroo Water Ltd over the next 40 years. The expected cost of these asset renewals has been included in the requested separation payment and will underpin the future sustainability of the scheme.

Key Risks

We assessed key risks to Tinaroo Water Ltd in our strategic planning and approached the market to help identify those risks that can be insured, and at what cost. Critical business risks include: ongoing viability and continued support of local commercial irrigation, loss or damage of critical assets, non-compliance with laws and regulations, injury to members of staff or the public, and requirements for future capital.

We believe that a locally owned and operated scheme will be best placed to work constructively with its members to ensure we all remain viable. Our separation payment request factors in critical asset replacement (including pipelines), adoption of SunWater's existing compliance and safety procedures and the establishment of a sinking fund supplemented by retained surpluses, to pay for future asset renewals and to cover unexpected future costs such as uninsured flood damage.

Consultation

The Business Proposal was developed in consultation with two irrigator reference groups comprising both large and small irrigators. Regular briefings were also provided to the Tablelands Canegrowers, local SunWater staff, Mareeba and District Fruit and Vegetable Growers Association, Mareeba Chamber of Commerce and local Councils. The Mareeba-Dimbulah Irrigation Area Council, a reference group drawn from 50 scheme customers, met four times during the development of the Business Proposal and on 23 October 2017 endorsed our submission to government.

PROPOSED TRANSITION DATE

If supported by government, Stage 4 (Transition Phase) implementation will proceed, targeting 1 July 2019 as the trading date for the local company.

2 Prices are increased by a real \$2 based in 2011-12. After including the impacts of inflation, the price increase is \$2.44 in 2019-20.

KEY BENEFITS/RISKS OF LOCAL MANAGEMENT

With or without local management

- ▶ Individual water entitlements will remain unchanged
- ▶ Bulk water assets will continue to be owned and managed by SunWater with bulk water pricing set by government
- ▶ Costs such as electricity are likely to continue to increase
- ▶ Water prices will be based on full recovery of operating costs and asset renewals.

Benefits of local management

- ▶ Members own the assets and elect a skills-based board to manage the company to deliver the agreed level of service to customers
- ▶ Entity reports to members annually
- ▶ Local office in Mareeba provides face-to-face customer service
- ▶ Local management expected to be more efficient than SunWater and pricing decisions relating to the scheme will be made by a member-owned company
- ▶ Scheme assets (replacement value of around \$425 million) are transferred to the member-controlled company at zero cost
- ▶ Government provides a separation payment to support the viability of the business into the long-term
- ▶ Replacement of leaking pipes is brought forward resulting in less breakage and future system efficiencies
- ▶ Customers have a direct say in the level of service

- ▶ Potential scheme modernisation and other income stream opportunities can be actively considered
- ▶ Entity structure provides protection against potential scheme takeover
- ▶ Member-owned entity sets channel distribution price without uncertainty of government involvement
- ▶ Local ownership gives greater opportunities for local employment and regional growth.

Risks of local management

- ▶ Members are unable to attract skilled people prepared to join the board
- ▶ Members elect a board unable to run the scheme in the interest of the scheme
- ▶ Board fails to put in place adequate risk management to deal with issues such as flood, asset failure and other risks of doing business
- ▶ Separation payment may be insufficient to cover costs and shortfall, which flows on to price increases
- ▶ Member company has limited ability to borrow in order to fund unexpected capital expenditure
- ▶ Pricing decisions are biased to the short-term to the detriment of long-term sustainability
- ▶ Insufficient funds are generated and retained progressively over the long-term for capital works (beyond 30 years).

The Investigation Board believes that all risks identified can be mitigated to an acceptable level and this has been addressed in detail in the Business Proposal.