

Forest Partnership Report

2nd November 2015

Hello,

Since my last report to you, we have seen a number of events affecting New Zealand. The Rugby World cup has given most of us pleasure, the humble and inclusive culture of the All Blacks makes one proud to be a New Zealander.

On the financial side, the signing of the Trans-Pacific Partnership Agreement (TPPA) will provide benefits for New Zealand forestry.

Tariffs on all forestry exports to TPP countries will be eliminated. While this only represents a \$9 million saving on present tariffs the forest industry anticipates there will be bigger prizes arising from the TPP agreement.

The New Zealand Wood Council has commented:-

"The focus of the TPPA has been on tariff reduction and elimination, but with wood products we suspect that non-tariff barriers are a much greater impediment to trade. Technical barriers that have no scientific justification can prevent the import or use of imported wood products. Subsidies enjoyed by domestic wood processors can also make it impossible for imports to compete fairly.

"The TPP creates a special relationship among the participating countries and we are hopeful it will become a permanent forum where other impediments to free trade, such as non-tariff barriers can be overcome."

Another positive the Council draws from the TPPA is the potential it creates for exporters of NZ processed wood products to compete in markets where they have until now been excluded by tariffs that escalate rapidly as value is added to a raw material.

"These lost opportunities are not included in the \$9 million saving, because current tariffs make exports unprofitable," says Mr McCallum.

"The Wood Council appreciates the hard work of NZ Government negotiators at the TPP talks. Once the agreement is ratified and becomes law there will be immediate small benefits for the forest and wood processing sector. Longer-term we hope to see much bigger benefits."

As I see it, the TPPA will provide greater opportunities for wood processing in New Zealand, any action that reduces the percentage of our forests being exported as logs is positive for the industry and regional employment.

We have seen extremes in weather from heavy snow around Gisborne and Wairoa hill country, to a very dry winter in the Hawkes Bay and then very heavy rain, that caused flooding in Gisborne.

The Gisborne and Wairoa Forests escaped the worst with snow damage in the main consisting of branch breakages and some limited toppling due to the weight of the snow, combined with very wet ground conditions. Track maintenance will clear up any litter to restore forest access.

We are all looking forward to some more settled summer weather.

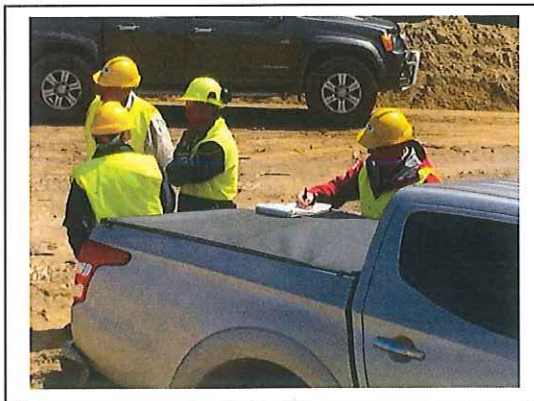
Waikare Forest Harvest

The first loaded logging truck left the Waikare forest (inland from Waverley in Taranaki) in February this year, bound for the New Plymouth port. This marked the start of harvest operations for the Waikare Forest Partnership and is the first Roger Dickie (N.Z.) Ltd forest to be harvested.

It is interesting to note the effect of freight cost on the net return (stumpage) of the Wanganui forests when compared with our East Coast forests. There is a \$7,000 to \$12,000 saving per ha for those on the East Coast.



The forest manager Steve Bell discussing the main Waikare access road with investors.



Waikare forest partnership investors completing the Health and Safety induction before a tour of the Harvest site.



Waikare forest harvest skid site. To date approximately 15% of the three year harvest plan has been completed.

Harvest Age

When we planted our forests it was forecast to be a 28 year project and that was the normal assumption by all consultants based on the information they had.

However, we planted our forests on predominantly fertile ex farm sites rather than lower grade land. As well, the climate and soils of the East Coast have contributed to produce very high growth rates in almost all cases. The outcome of this is that we can begin harvest on most of our forests at age 26. Because the harvest will be spread over three years the harvest age will be 26 to 29. Interestingly pre harvest inventory is showing that some of our forests will produce the same volume at age 26 as was forecast for age 28.

Because harvest will begin at age 26 in most cases our pre harvest planning and roading will begin from about age 24.5 years.

Earlier income will of course improve the return of the investment. Our present calculations show that Waikare forest will return around 7% and we would expect most of our East Coast forests to have Internal Rates of Return (IRR) in excess of this.

Forest Insurance

PF Olsen Limited has provided the annual Tree Crop Insured valuation as at 30 September 2015 for the RDNZ forests. They have assessed the value to be \$389 million, an increase on last year of \$6 million.

We went to the market for two quotes and we have rolled over the forest insurance under the same terms and conditions. We have increased the claims preparation sum insured from \$250,000 to \$500,000 based on anticipated professional fees and other expenses incurred managing a loss and preparing a claim agreed by the insurer following the loss or damage to the forestry area.

In general there has been a 5% increase in Forestry Insurance premiums, and with the increased sum insured, we have managed a 3% increase.

Our insurance costs per ha are higher than some other New Zealand forest owners. This is because almost all forest insurance works on a first loss basis where only a percentage of the total crop is insured. We are told our first loss cover of \$40 million is the highest in New Zealand, the outcome of this is that in a catastrophic (Cyclone Bola or worse) event we would receive significantly more.

At the 2014 AGM's it was resolved to *'utilise the Partnership's share of the insurance fund to pay the wind and fire insurance premium until those funds are exhausted'*. After payment of this year's premium, the insurance fund has a value of \$1.960 million. I estimate this should cover the premiums for the next two years, based on the current premium.

We have also rolled over the public liability insurance with Aon. The premiums have increased on average \$15 per forest.

Liability free NZU's

We are selling the Forest Partnerships liability free NZU's progressively as required to pay the forest expenses. A recent sale of NZU's saw a price of \$6.55 each. Prices have been over \$7.10 and are anticipated to continue rising.

Financial Markets Conduct Act 2013

We continue to make changes to our business to meet the Financial Markets Conduct Act (FMCA).

There has also been a change with our Statutory Supervisor. The shareholding in Foundation Corporate Trust has changed and the new ultimate owner is called Complectus Ltd. Complectus Ltd also owns Guardian Trust and Covenant Trustees Ltd.

We are told that the ultimate intention is to amalgamate Covenant Trustees Ltd and Foundation Corporate Trust. For the time being Foundation Corporate Trust continues as a stand-alone entity and our obligations and contractual arrangements remain in place.

Apart from death, there is only one thing we can be sure of in this world and that is change.

Foundation Corporate Trust are pushing an initiative to seek an exemption from complying with the FMCA for closed forestry partnerships. We are uncertain about this, but will monitor progress with interest.

We continue to be aware of compliance costs and managing those costs.

Anti Money Laundering and Countering Financing of Terrorism Act 2009

As part of our compliance with this Act, we will continue to ask for your Identity to be verified with Photo ID, proof of address and your bank account details. This will become particularly important when:

- a forest is being harvested and before distribution of income is made, or
- you have sold your participatory securities in a forest partnership and before settlement can be made.

Log Markets

Domestic: The domestic log market is expected to remain firm based on steady New Zealand economic growth, a strong housing market and increased residential and commercial construction activity.

Export: The 10 year trend shows steadily increasing China log import volumes from their major supply sources, such as USA, Canada and New Zealand. This has been assisted by decreases in domestic harvesting in China, as environment initiatives lockup timberland.

Log Price Outlook: With continued drops in log inventory in China, prices are expected to continue to firm. Since the beginning of October the NZ\$ has strengthened against the US\$ which has effectively offset any price increases.

Stocks in China are reported to be dropping by 100,000 m3 per week, and are expected to be below 3 million m3 by the end of October.

source: Wood Matters, issue 80, October 2015.

Secondary Market

If a partner wishes to sell their participatory securities, under the rules the securities must in the first instance be offered to the other partners under the pre-emptive rights clause.

History shows that they generally get taken up to varying degrees within that forum. Any residual securities can then be offered outside the partnership on the secondary market.

If you are interested in securing an investment in another partnership, you can view the current listings we have on the website or please contact Richard Bourne in our office or email richardb@rogerdickie.co.nz

Forest Visits

You are always welcome to visit your forest at any time, however FMNZ run a permit system and need to keep track at all times, when anyone is in the forests. If you wish to visit your forest, please telephone the FMNZ office in Napier on 06 843 3770. Your co-operation is appreciated.

Staff Changes

We welcome Abbey Luff into the office as Forest Administrator. You will hear from Abbey more as we get closer to the AGM's.

Regards



Roger Dickie

Forest Managers Report September 2015

The past six months have been notable in the extreme variability of the weather. We have had heavy snow around Gisborne, Wairoa and Hawkes Bay have had an unusually dry winter and the Whararatas recorded 175mms of rain over a two hour period while some areas in the Whanganui region recorded 250 – 300 mms, most of which fell over a twenty four hour period. While writing this report, heavy rain has caused flooding in some areas of Gisborne, Wairoa and Hawkes Bay. As soon as weather permits, we will check the forests to assess any damage.

Forest health is generally very good with little sign of red needle cast (RNC) at present. The trees which had been infected with RNC have defoliated and are growing the needles back. There is plenty of evidence of new, healthy spring growth and as usual for this time of year, every breeze brings clouds of pollen with it.

The bi-annual forest health surveillance programme is due to be carried out later this year and we should have the reports to hand by the end of the year. The programme is managed by the Forest Owners Association (NZFOA) for the benefit of their members and has been operating since the 1950s. It presently includes a combination of aerial inspections, forest visits, ground plots and surveillance of “high risk” sites and culminates in a report to the forest owner.



**The track up the hill from the
Waikoau River – Stand 1**

When the implementation of a forest commodity levy was voted on in 2013, it was proposed that some of the levy funds would be used to expand the forest health surveillance programme to include all forests, not just those of NZFOA members. In addition, the programme was to be designed to protect NZ trade from the negative effects of new pest and pathogen incursions as well as protecting our forest estates by early detection of new to region and new to NZ incursions.

The redesigned system will be trialled early next year and introduced in July 2016. For the forests we manage, the most likely change will be that some forests will be surveyed more frequently and some less frequently, depending upon their location in relation to ports, airports, camp grounds, etc. These are considered high risk facilities and are areas where organisms from overseas are most likely to enter NZ.

The snow in the Gisborne region during July did reach Glenview however it was a very light fall and there was no damage to the forest from this. We have been lucky as many of our Gisborne properties had varying degrees of damage including toppled trees and broken out tops.

Tracks are in reasonable condition and this is largely due to the dry winter conditions in Hawkes Bay/Wairoa. There is some minor water damage and scouring of creek crossings however, we still have access right around the forest. Tracking maintenance is scheduled for November and given the present condition of the tracks, we may choose to forgo maintenance for this financial year provided they stay in this condition. We will make this call later in the year.

The pre harvest inventory is scheduled for October. The information gathered from this inventory is used to calculate grade outturns and recoverable volumes from the forest at harvest. This allows us to run various grade outturn and pricing scenarios to calculate forest returns and the information is also useful for our harvest planning.

Our possum control maintenance work was completed in April. While we have not recorded a high kill rate, the poisoning allows us to keep the possum population to a low level. There are more than the usual number of goats in the forest at present and this is most likely due to the dry conditions over winter making the feed in the surrounding farmland shorter than usual.

As confirmed at the annual general meetings this year, the liability free NZUs are to be used to fund forest operating expenses in place of sharecalls. We are selling units as we are advised funds in the bank account are dwindling. In June, we sold 2,000 NZUs for Glenview at \$5.25, less 5c commission per unit. This leaves 32,701 liability free units available for sale and they are presently valued at around \$6.55 each.

Earlier this year, we received a letter from Unison Network advising that in one of our forests there were “a large number of trees encroaching into an area around Unison’s power lines that should be kept clear to ensure the protection and safety of our mutual assets”. They suggested that in order to protect the trees and ensure they do not cause damage to Unison’s assets, an appropriate corridor be established either side of the power lines. The appropriate corridor they suggested involved the removal of approximately five hectares of trees at the forest owner’s cost, with no suggestion of compensation.

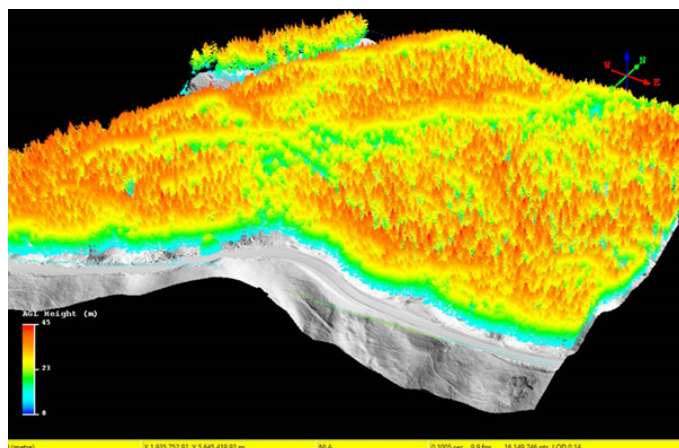
The neighbouring forest had also received a letter from Unison and given the impact this may have on any forest with Unison Network lines running through it, we decided to seek a legal opinion on the matter as it potentially has serious ramifications for all forest owners with Unison lines running through their forest. The cost of the opinion was shared 50/50 with the neighbour and we have charged the fees to the forests we manage that are potentially affected, the cost is \$101 each.

The opinion tells us that Unison are attempting to widen the tree corridor around its conductors beyond what it is already entitled to under the Electricity Regulations 2003. If Unison feels the

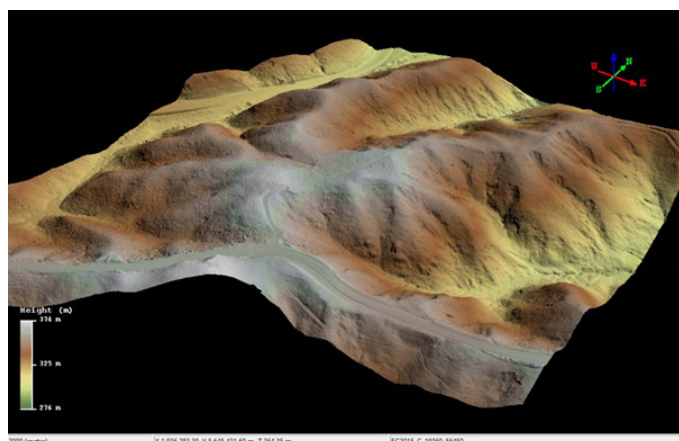
legislation does not provide for a sufficient corridor, then the way forward is by negotiated agreement between the respective parties. The opinion was sent to Unison and to date, we have not received a response.

Progress has slowed on the re-opening of the Napier/Gisborne rail. The Hawkes Bay Regional Council (HBRC), were unable to reach agreement on a lease with Kiwirail by the 30th June deadline so Kiwirail are now seeking proposals for both the use and maintenance of the mothballed line. They have called tenders for a non-exclusive licence and it will be interesting to see who the occupier will be and whether the network will be used for freight or tourism. The tenders close mid-September and a decision is due to be announced by mid-October.

Given the quantum of the harvest planning ahead of us as the forests approach maturity, we have been looking at the most cost effective and efficient tools available to us to assist with the planning process. Lidar is a remote sensing technology that uses light in the form of a pulsed laser from the air to measure distance to the earth and analysing the reflected light to generate precise, three dimensional information on the surface characteristics of the underlying terrain. This information can then



Glenview Forest showing tree coverage and stocking gaps. Individual tree counts and heights can be ascertained from this image.



Digital terrain model of Glenview Forest showing topography of land with trees removed.

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be used in our harvest planning to design roads, landings and skid sites with a great deal more accuracy than the 5 metre contour line maps we have previously worked with.

Until recently, the cost of a Lidar survey was prohibitive however, a combination of advances in the technology and economy of scale obtained by carrying out surveys over larger areas has brought the cost down from \$15+ per hectare to \$7.75 per hectare. We joined with Pan Pac who were surveying their Hawkes Bay forests and had Glenview, Saddleback and Tangoio Forests surveyed in preparation for the commencement of their harvest plans.

Over the winter there has been media coverage on examples of cutover debris flows and the mess this leaves on beaches and beside waterways. Debris flows occur when a significant rain event, such as that experienced in the Whareratas and the Whanganui regions recently, saturate the land and the soil structures give way causing erosion, sediment deposition and debris flows. The land is vulnerable to damage up to three years post-harvest, during the infancy stage of the next rotation.

Naturally those downstream from the damage or the public using the beaches littered with harvest slash want foresters and local authorities to pick up their act and either prevent, or clean up the mess. Gisborne District Council proposed placing a levy on the forest sector to cover the cost of clearing up the debris however, after submissions from the forest industry, have chosen to put the levy on hold.

Problems caused by debris flows and harvest slash emphasise the importance for forest owners to work to best practice guidelines found in the NZ Code of Practice for Plantation Forestry and NZ Forest Engineering Manual. While this will not prevent the problem altogether, it will go a long way to reducing the volume and movement of debris.

Adhering to codes around road design and skid construction, rehab of streams, slash management and removal of all merchantable logs, the installation of silt and slash traps, riparian planting and setbacks and in some instances, retirement of land is essential if we are to achieve a reduction in this kind of environmental damage.

The National Environmental Standard for Plantation Forestry (NES) will also be of assistance in helping to reduce post-harvest damage. The intent of the proposed standard is to improve national consistency in local authority plan rules relating to plantation forestry and to provide certainty for those involved in managing plantation forests by removing the differences in the rules between the territorial authorities.

The draft rules that make up the Standard are variations of those found in existing regional and district plans and in many cases, are based on best practice examples from existing plans. The focus is to create a single set of rules for plantation forestry that will apply throughout NZ.

Representatives from environmental groups, forest owners, local bodies and technical experts have been working on drafting the NES for the past seven years. The draft went through a public consultation process in June and will hopefully be gazetted in early 2016.

Steve Bell
Forest Manager