Forest Partnership Report

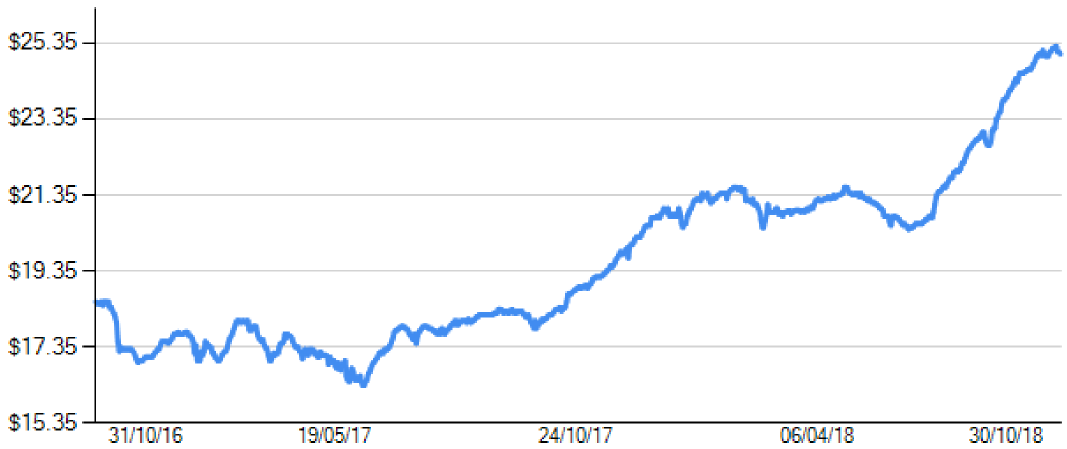
October 2018

Hello,

Its been a busy few months since our AGM correspondence, - we've had the new government settle in and begin to bring forward some of their policies and ideology. Minister Jones has a large fund to invest in the rural economy, and the Government (read New Zealand First) are trying to stimulate the Billion Trees programme – more on this later. We've had Trump placing tariffs on China, and this is ruffling a few feathers for our log exporters. Our forest managers FMNZ have started another 5 crews in our partnership forests. We have secured another 2,000ha of greenfields (farmland) to be established into forestry for foreign owners, and as well, intend to register a PDS (Product Disclosure Document) with the Financial Market Authority, to promote and sell forestry investment in a partnership style format to retail investors – similar to a partnership prospectus.

Carbon Update

The carbon market (price of a New Zealand carbon credit) for NZU's was relatively steady at around $21 for the first part of the year. In the last couple of months the price has lifted to sit around the capped market price of $25 (in some instances it has been trading above the cap). We think that there will be continued upwards pressure in the price of Carbon moving forwards.



New Zealand Carbon Price

In August of this year Te Uru Rakau (Forestry New Zealand) and Ministry for the Environment proposed significant changes to the Emissions Trading Scheme that will be of major economic benefit to people undertaking new forest planting in New Zealand.

One of the factors which will have a major effect on forest new plantings and investment is the government proposal to move to averaging for NZU's (carbon credits). Averaging would allow a newly planted forest to progressively (as the carbon is sequestered) sell about 450 to 500 tonne of carbon per ha with a present value of around $12,500 per ha. This means at the age of about 17 to 18 years most if not all costs including land purchase and the establishment and management of the forest would have been refunded from selling NZU's. Effectively the averaging proposal means that a forest investor planting new forest on farm land can enter the forest industry for very low or zero cost. From a business perspective it is obvious there will be a significant uptake by forest investors.

A new wooden building fitout inside a high-rise engineered timber building.

The only obligation with this averaging proposal is that the forest must be replanted after harvest to retain the benefits of the NZU sale.

Te Uru Rakau propose that the averaging proposal will begin in 2020, but an owner may be able to opt in during 2019.

There are logical reasons for the newly proposed averaging rules

- Forests are an important part of the emissions reduction programme needed for New Zealand to meet its international commitments on CO_2 emissions over the next 30 years.
- Averaging of CO_2 in forests is logical because it correctly reflects the average carbon tonnage held in a range of post 1989 forests
- The averaging proposal will be much easier for government to administer than the safe carbon policy we are presently operating.
- The averaging proposals will make it much easier for government to achieve its billion trees planting programme i.e. increased new plantings are now government policy.

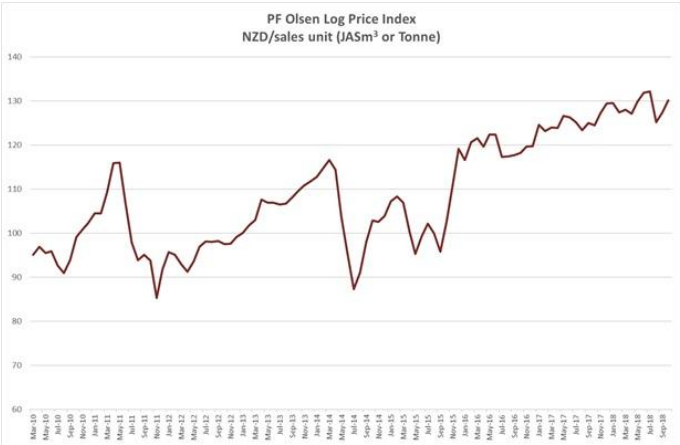
We have researched the probability of this averaging proposal being confirmed by Government. Senior officials have told us that the averaging proposal is highly likely to happen.

Read more about the proposals here https://www.mpi.govt.nz/news-and-resources/consultations/a-better-ets-for-forestry

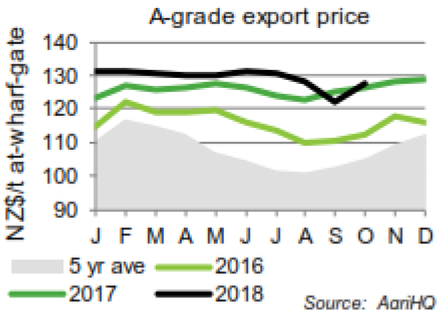
Log Markets

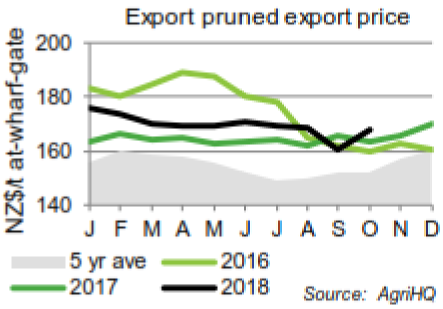
With 8 of our forests now harvesting and 9 more to start in 2019 it's pleasing to see the continued upward trend of log prices.

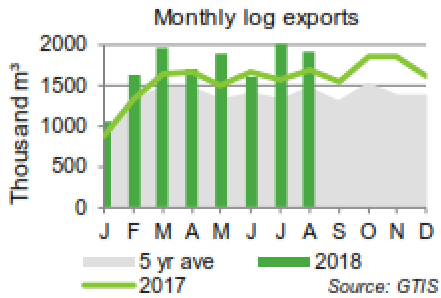
The PF Olsen Log Price index is at $130 per tonne for October. This is $4 above the two year average, $6 above the three year average and $15 higher than the five year average.

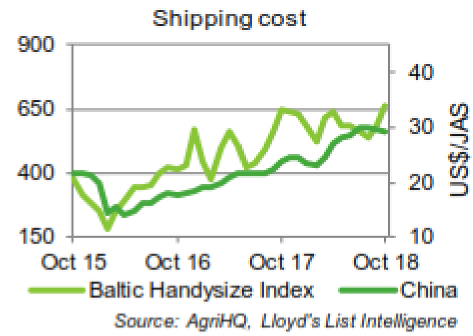


This Index is based on prices weighted in proportions that represent a broad average of log grades produced from a typical pruned forest with an approximate mix of 40% domestic and 60% export supply.









The October report from Summit Forests sums up the export market well:

As it is now the busy season in China & there is a limited supply of North American Logs, port inventory has begun to decrease, and the domestic price of logs has begun to increase. The demand for pruned logs remains limited as the US trade war continues to affect wooden furniture exports.

Currently there is a 10% tariff on wood products exported to the US from China. This came into effect on the 24th of September. At present this increase can be absorbed between the buyer & seller. However, this tariff might lift to 25% in January 2019, having a major impact on profitability for those manufacturers.

Overall the demand in China for radiata pine is still good, particularly for construction.

AWG (At Wharf Gate) Forecast
We anticipate CFR (Cost & Freight) levels to increase slowly towards the end of the year. Watch closely the balance between forecast moves downwards in FX, creeping freight rates & small step-ups in CFR. The result is likely to be strengthening AWG prices.

Insurance

The insurance cover has been renewed for the current tree crop. Once again, the per unit rate has not changed however the total sum insured has increased, so we are seeing an increase in our premiums. We have kept firefighting cover because the new FENZ levy still has some uncertainty around it. As more of our forests begin harvesting, we have added a small amount of infrastructure cover to the policy. If an event in our forest caused damage to a culvert or harvest roading infrastructure, this would now be covered.

National Environmental Standards

The National Environmental Standards for Plantation Forestry (NES-PF) came into force on 1 May.

The NES-PF is a set of nationally applied rules and conditions for plantation forestry that was developed to better protect the environment while also increasing operational certainty for foresters. The NES-PF was designed to provide rule consistency for forestry across the county.

The Tolaga Bay floods in June brought with them large amounts of logging slash from recently harvested forests in the hills above. Mindful of this, our forest managers (FMNZ) will review their harvest plans for harvesting on steep slope forests. They have amended the harvest plan at one of our harvesting forests to address environmental issues and mitigate, as best they can, any such movement of slash and soil occurring. They have decided to spread the harvest for that forest over a longer term to avoid harvesting some of the steep slopes near the river in the winter months.

2019 Forest Visits and Meetings

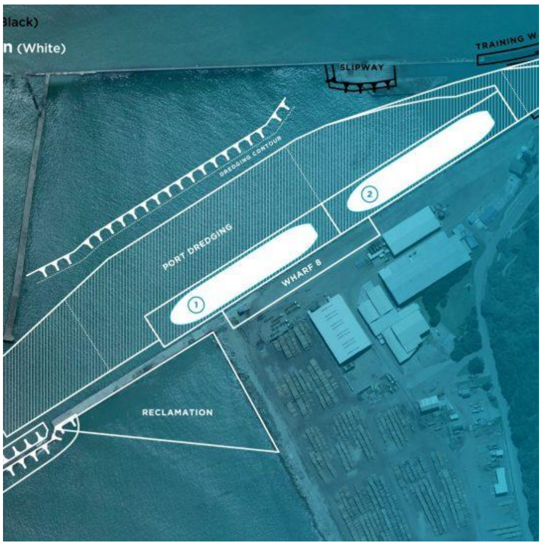
Please note the dates for the 2019 forest visits and meetings are available on our website.

Power Corridors

In my end of year partnership report I discussed that the Unison lines company are seeking to recover the cost of repairing damage to their lines from trees that blew over in a wind event. Our public liability policy covers these events. Our trees are planted outside of the legal easement required for power corridors and we have repeatedly said we will remove any trees they would like to identify outside of this corridor provided we are compensated. Unison do not want to settle the case and we are proceeding to trial in May 2019. This will be a significant case and the Forest Owners association are supporting us with the trial as any decisions made here may set a precedent for the forestry sector. In some of our forests it could result in the loss of significant areas. On behalf of the partnerships we have engaged the services of a lawyer with significant experience in this area to ensure the best possible outcome in the trial. (Note – the cost of the trial is being met by the insurance company, we have engaged independent legal services to oversee some aspects)

Gisborne and Napier Ports

One of the significant projects for the regions that Minister Jones is funding from the regional growth fund is the Twin berthing (two ships) of logging ships in the Gisborne port. This involves an extension of the current wharf to facilitate the loading of two ships at the same time which will increase capacity from approximately 3millon tonnes to 5 million tonnes on completion. The development is welcomed by the forestry sector and the region who benefit significantly from the upgrade. You can find out more at www.twinberth.nz



Napier Port on the other hand, as a multi-use port, needs to keep developing and innovating to keep up with the supply of logs. Twice now we have seen increased freight costs being incurred by our forests due to delays with scaling and unloading at the port. Every time a cruise ship visits the Hawkes Bay, logging ships are required to stop loading logs and leave the port for the duration of the cruise ships stay before returning to the dock to continue loading – as you can imagine this is highly inefficient. Although it is the exporters job to liaise with the port, I am taking an active role on behalf of our forests, as any delays ultimately cost us as forest owners.

Log Scaling

As with the port, we are seeing hold ups with the scaling sheds measuring our logs before they are delivered. As some of our harvesting forests know, this has directly resulted in increased transport costs. Last month I was in Napier when there were 25 logging trucks waiting on the road to be scaled. We are developing a site in Napier with Weigh Solutions and are in discussion with the log scaler to implement a system that will give priority to our logs.

Tax on Harvest Income

We're frequently surprised at the lack of understanding around tax on your harvest income. In a few instances we have heard of investors paying too much tax by not spreading income or reviewing the ownership structure of their partnership interests. We strongly recommend that you take specific forest accounting advice.

Jeff Whitlock, the forest Partnerships Accountant, is an expert in forestry accounting and tax filing and acts for many of our clients. Jeff can be contacted at (06) 346 7070

Secondary Market

There has been very little activity this year with Partnership Interests generally being taken up by partners in the pre-emptive rights phase of a sale. This has seen very few offerings come onto the secondary market outside the individual partnership. The most common reason for selling seems to be for those who want an injection of cash for retirement or helping children into a home. We are bringing a new property to market with early income from the sale of Carbon – see below. We do have shares for sale in the dairy farms in Southland, please contact the office to find out more.

New Investment Opportunity

As discussed above we are working hard to bring a new Greenfields Forest Partnership to market. The Government is committed to getting new plantings underway to meet our emissions targets and is incentivising new greenfields planting. The 374 hectare property is located just 34km from Gisborne Port and neighbours our Chatswood and Heywood Forest –planted in 2000 and both exhibiting excellent growth.

Karaka Station with Chatswood and Heywood in the background.

The current Emissions Trading Scheme is under review, proposing more 'liability free' units are available to a forest owner. These units when sold can cover most of the cost of establishing and managing the forest through to harvest. Current projections for private forest investments (we are already planting an additional 2,000ha next winter) show most investor money returned by year 16, and IRRs of above 6.5%. The forests are still grown to harvest logs, with the bonus of early income from carbon.

Under the Financial Markets Conduct Act, there are new disclosure requirements, and a PDS (Product Disclosure Statement) which replaces an older style 'prospectus' governs how financial products are created, promoted and sold. We are working the documentation.

To register your interest and receive priority information please call or email Richard or Grant.

Regards

Roger Dickie | Will Dickie

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