

Tips For Forestry Investments

Farm Forestry in the Adelaide Hills / Fleurieu Peninsula - Farm Forestry Note 11/05

This Farm Forestry Note provides an introduction to options for investing in forestry and will assist you as a potential investor in judging the merits of various options and schemes.

Overview

Interest in forestry as an investment vehicle has increased over recent years and it appears set to continue increasing into the future. A number of factors have contributed to this:

- The interest generated from the apparent success of plantation grown woodchip projects aimed at supplying the Asian paper industry with wood fibre.
- The interest generated by the prospect of carbon credits trading as a measure to combat the Greenhouse climate effect.
- A move in Federal government policy to see Australia change from being a net importer to an exporter of wood products.
- The desire for “clean green” investment options.
- The promising returns forestry investments offer amid the downward spiral other agricultural and mineral commodities are offering.

Internal rates of return achievable through forestry investments can be typically in the order of 5 to 20%.

The diversity of forestry enterprises available offers a range of medium (10 year) to long-term (30 years) investments with varying degrees of risk and liquidity. It is important that you as an investor match your investment requirements against the characteristics of any particular forestry investment scheme. Important factors for you to consider include your desirable timeframe for returns, your individual income tax position, superannuation needs and any requirements you may have for deferring income.



Options for private investment in forestry

Investing in forestry indirectly

A low cost input way to invest in forestry is to buy ordinary shares in a forestry company. This investment allows the investor the option to still be involved in forestry, without large capital outlays at the beginning of a project.

Investing in forestry company shares also allows the investor high liquidity, with capital able to be withdrawn at short notice.

Investing in shares in a forestry company can also be relatively low risk when compared to operating as an individual committing to a long - term forestry project.



Investing in forestry as an individual

Investing as an individual requires all responsibility for the project to be taken by the individual investor. This will include all aspects of the development, finding suitable land, selecting appropriate species, establishing, maintaining, harvesting and marketing the plantation. While consultants and contractors are available to assist with some, or all, of these aspects the ultimate responsibility and risk of the investment lies with the individual. With this greater risk however goes the potential for much greater returns.

Investing on an individual basis generally requires larger inputs of capital to make the project of an appropriate scale to attract industry.

Leasing land rather than buying land is a way of reducing the initial investment required.

Forestry Rights legislation provides a mechanism that allows the legal separation of land and tree ownership. Separate ownership of the trees from the land will allow trees to be traded before they reach maturity, providing investors with a more liquid investment opportunity.

Forestry rights will allow investors and landowners to develop cost and profit sharing schemes relative to their individual contributions. These types of schemes usually rely on a ‘broker’ bringing the parties together.

The second component within Forest Rights legislation provides harvest security against future possible environmental and conservation restrictions on harvesting the trees.



RURAL SOLUTIONS SA

Investing in forestry as a private group

Rather than collective indirectly investing in 'woodlots' in a prospectus company or shares, individuals and small groups of investors can invest more directly in forestry.

Groups of less than 20 investors do not have the expense of prospectus preparation and a 'product ruling' from the Australian Tax Office (ATO). However, such 'sophisticated' investors will need to have assessed the same factors as addressed in an approved prospectus and obtain individual 'private rulings' from the ATO.

There is an expectation of greater reward for a more hands-on approach. Corresponding risk is possibly, but not necessarily, greater than it is for indirect investments.

Investors such as busy professionals with high net income streams can engage the services of entrepreneurs to coordinate the land procurement, investment structures and associated legal agreements, tax rulings and contractors for establishment, management, harvesting and marketing.

The cost structures, projected returns and associated profitability will necessarily vary from project to project.

It is important to note that the contributions within the group will vary in quantity, format and timing. It is important that any returns sharing is based on the full cost contribution ie the initial capital and the interest foregone, as the different parties will provide services over a different time frame.

Investing in forestry through a prospectus

This relies on collective investment and the registration of a prospectus with the Australian Securities and Investment Commission (ASIC), in accordance with the Managed Investment Act 1998. Previously the pool of managed investments would have been under the supervision of a trustee, who is appointed to protect the rights of the growers, and a "manager" who conducts the project.

Under the Managed Investment Act, this dual role has been replaced with a "responsible entity" which holds and manages the investment. A "responsible entity" (RE) must be a public company with a securities dealer's licence, and the managed investment scheme must be registered and have a compliance plan that conforms to Corporations Law. This type of scheme brings together a number of investors or "growers" and so allows for more modest capital investment.

The project manager is responsible for securing land for the project, establishing, maintaining and marketing the plantation.

The land is divided into lots and each investor enters into a "lease and management agreement" to lease an identifiable lot and to contract with the single responsible entity for the project to establish a plantation on the leased area. The "grower" or investor then receives the proceeds from the harvest of the plantation.

Variations to investment schemes generally arise in two areas:

Lease of land – security of tenure is vital. Land is usually sub-let from a third party through the RE. A variation is for the growers to own the land either by purchasing it directly through the RE or by taking shares in a company that purchases the land and subsequently leases it to the project.

A once only fee or an annual lease and maintenance fee – generally there is a once only payment to enter the project that covers establishment costs, lease payments and maintenance costs for the duration of the project. A lower initial payment covering establishment costs can be an option if an annual lease and maintenance fee is paid every year throughout the project.

A checklist of information that you should seek before investing in any afforestation scheme should include all of the following:

The nature of the investment – is the investment a lease and management agreement, an issue of shares, a unit trust?

A description of the project – how does the development fit in with the local industry, scale of planting, species used, product, existing infrastructure, all considered from establishment to harvesting and processing of the wood?

Taxation – is there a report prepared by a qualified taxation expert detailing treatment of the project by the Australian Taxation Office? Has the project been given a Product Ruling by the ATO?

Land information – how suitable is the land for the project and what security of tenure is there?

A consulting forester – is there a report detailing the suitability of the land, the establishment strategy, the future silvicultural regime, likely growth rates, environmental considerations and adherence to codes of practice? Are adequate on-going reports throughout the rotation provided by the consulting forester to investors in the scheme?



The project manager – who is responsible for managing the project and what is their experience in such projects?

Insurance – what are the details of any insurance, what is the amount of cover and who is the underwriter?

Future costs – what cash or securities are held to ensure the manager has the resources to properly manage the project? eg maintenance and fire protection costs. Are the costs for the project up front or are there other ongoing costs?

Anticipated returns – what are the likely returns and what are the assumptions on which they are based? What guarantees are there for purchase of the wood? Are there existing markets for the product?

Anticipated dates of returns – in what year are returns likely to be distributed? Is there an option for a second rotation, and if so who holds the option (the project manager or the investor)?

Disclosures – is there a disclosure of any transactions to which either the promoter or manager are a party?

Further information including “*A guide to information to be provided by afforestation investment companies,*” is available from Australian Forest Growers.

If you are unsure about all or any of these issues, seek further information from an independent and reputable financial adviser, a consulting forester or Australian Forest Growers.



References

Bulman P (2002) *The feasibility of attracting significant private investors (SPI) into non-prospectus forestry investment — a study for the Mount Lofty Ranges Farm Forestry Group*

Jenkin B (2000) *Plantation Forestry as an Investment: how to participate and share the returns*. Australian Forest Growers Biennial Conference Opportunities for the New Millennium Cairns convention Centre, Queensland, Australia September 4 – 6, 2000

Developed by Rural Solutions SA - Private Forestry

For further information, contact the Mount Lofty Ranges Farm Forestry Program

at the Mount Lofty Ranges Catchment Centre, Upper Level, Cnr Mann & Walker Sts, Mt Barker, 5251

Phone : 8391 7500

Disclaimer

Use of the information/advice in this booklet is at your own risk. Rural Solutions SA and its employees do not warrant or make any representation regarding the use or results of the use of the information contained herein as regards to its correctness, accuracy, reliability, currency or otherwise. The entire risk as to the results from the implementation of the information/advice which has been given to you is assured by you. All liability or responsibility to any person using the information/advice is expressly disclaimed by Rural Solutions SA and its employees.



RURAL SOLUTIONS SA