



National Farmers'
FEDERATION

**INQUIRY INTO AGRIBUSINESS MANAGED INVESTMENT
SCHEMES**

NFF SUBMISSION

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Introduction

The collapse of two of the largest Managed Investment Scheme (MIS) operators, Timbercorp and Great Southern Plantations, has intensified the focus on the MIS mechanism and how appropriate it is (or is not) for rural and regional Australia. The recent series of events has also highlighted some of the concerns that the National Farmers' Federation (NFF) has voiced for some time about the mechanism, particularly in relation to the reputation of agriculture as an investment option.

In recent years, MIS have escalated in their ability to generate significant investment in plantation forestry and to a lesser degree other agribusiness projects. This has particularly been the case since the Plantations 2020 Vision was launched by the then Minister for Primary Industries and Energy, The Hon John Anderson MP, in October 1997. Australian Agribusiness Group's seventh annual survey of funds raised in the MIS industry showed the sector managed to raise \$1.079 billion in the 2007/08 financial year. Non-forestry projects received 35% of total MIS funds (\$378 million).¹

The NFF has been publicly concerned about the exponential growth in MIS forestry projects and believes that the MIS mechanism does not promote sound investment decisions in rural and regional Australia. The NFF believes that many MIS projects have created negative distortions of resource allocation in regional areas.

The NFF believes that decisions to invest in MIS are largely based on the tax deductibility of the investment, rather than driven by long-term profitability. As a result, MIS have traditionally been primarily focused on industries with a high proportion of up-front expenses, with little regard given to the output returns generated.

The Australian Taxation Office (ATO) Commissioner ceased issuing product rulings for non-forestry MIS projects on 30 June 2008 based on his interpretation that investor contributions in these schemes are capital in nature and therefore not deductible. The NFF understands that the ATO, in conjunction with the MIS industry, is currently progressing a test case in the full Federal Court on this matter. The outcome of this test case may have implications for both forestry and non-forestry MIS schemes and this review should be undertaken in this context.

The effects of Managed Investment Schemes

Distortion of Land Values and/or Commodity Markets

The NFF believes that current MIS structures do not promote sound investment decisions in rural and regional areas, and as such have created a distortion of land values and/or commodity markets.

It is the NFF's view that the enormous growth in investment in MIS since 2000, has largely been driven by the taxation structure of the schemes. The NFF believes that decisions to invest in MIS are largely based on the tax deductibility of the investment, rather than driven by long-term profitability. As a result, MIS appear to be primarily focused on industries with a high proportion of up-front expenses, with little regard given to the output returns that are generated.

It has long been the belief of Australian farmers that prices are a fundamental signal for farmers about what to produce, where and in what quantities. Farmers need governments to allow market

¹ Farm Online Website, <http://theland.farmonline.com.au>, accessed on 23 July 2008

forces to work, and in doing so, create a global food production environment that is more flexible, reliable and sustainable. As is the case with the current plethora of government distortions within the global trade of agricultural goods, the NFF believes that the MIS mechanism is also acting to mask price signals for farmers, leading to inefficient allocation of the world's scarce resources and exacerbating the global food security issue.

On the issue of land values, the dollars generated by MIS have enabled these schemes to bid from a position of relative advantage in terms of their access to capital. In terms of commodity prices, MIS have seen investment continue into industries on unrealistic expectations of price, resulting in a distortion of basic market signals.

A new area of concern for NFF is the move of MIS into the developing water market and the potential for this to distort water prices and water access. The capacity for the schemes to manipulate a developing market is likely to significantly undermine the Governments' intended policy outcomes for the water trading market. There are also a range of considerations relating to the physical limitations of river systems to deliver the required increased water demand, including a move from the fringe irrigation periods (i.e. autumn and spring) to a concentration to the summer period (and particularly the peak period of January). These considerations constitute further unintended outcomes of the MIS structure. In this regard, the NFF refers to the 2006 Productivity Commission Discussion Draft on Rural Water Use and the Environment: the Role of Market Mechanisms. This report states that for *"any tax concessions (MIS), there is the potential to distort resource use and prices (including for rural water) by directing economic resources away from, or towards, particular activities. Associated losses in resource-use efficiency can ensue"*.

Policy intent

The NFF questions whether MIS are delivering on their initial policy intent. In October 1997, the then Minister for Primary Industries and Energy, The Hon John Anderson MP, stated that he wanted to 'enhance regional wealth creation and international competitiveness through a sustainable increase in Australia's plantation resources, based on a notional target of trebling the area of commercial tree crops by 2020'. The key tool for accomplishing this goal was MIS.

With almost 35% of MIS now accounted for by non-forestry projects, NFF questions whether this indirect form of support continues to effectively deliver targeted assistance to an area of perceived market failure.

The NFF firmly supports the provision of direct and transparent mechanisms that provide targeted assistance to those sectors of the market that require help in managing risk. However, the NFF believes that MIS, in its current form, does not meet these criteria in delivering industry support, particularly given that a significant proportion of the initial investment is channeled to promoters, financial advisers, and other peripheral agencies.

Transparency of Managed Investment Schemes

The NFF has significant concerns about the adequacy and independence of information available to potential investors in agricultural MIS and the potential for undue influence of the ATO product ruling processes.

The Rural Industries Research and Development Corporation (RIRDC) suggests that the overall MIS sector continues to perform poorly with respect to realistic or actual rates of return versus projected

rates.² It is therefore the NFF view that an appropriate level of market accountability by promoters and managers of MIS projects has been lacking.

While the NFF recognises that some MIS already provide detail on the long-term financial performance of the schemes, the NFF does not believe the current system can be assured of delivering accurate and independent information which is commercially evaluated by industry experts.

The NFF is also concerned that the high commissions offered to financial planners by MIS promoters (as reported by the Australian Financial Review to range from between 10% and 13%), has the potential to provide undue incentive for planners to invest client dollars in such schemes. In addition, the NFF is concerned that by the time the MIS pays the fees to tax lawyers, tax accountants, fund managers and scheme promoters, then only a small percentage (<35%) of the total MIS investment dollars are actually being used in the venture.

The reputation of Australian agricultural investment

The NFF has always been concerned that MIS have the potential to damage the reputation of Australian agriculture as a competitive investment option for people in metropolitan areas. This concern has now come to fruition with the demise of Timbercorp and Great Southern Plantations, which has painted agriculture in an extremely poor light. The poor perception of agriculture is a fundamental concern to the NFF as our organisation is committed to the long-term understanding of, trusting of and willingness to invest in agriculture into the next generation.

With real rates of return from MIS continuing to underperform against the promoters' projections, we are now seeing metro-based investors losing confidence in the agricultural sector as a whole. This comes despite the underlying fundamentals for agricultural commodities being extremely positive. The March 2009 national account figures were a timely reminder of the underlying strength of the Australian farm sector, with agricultural production and growth – in seasonally adjusted terms up 10.9% in the December 2008 quarter on top of the previous quarter's 13.4% – helping to stave off recession.

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² RIRDC 2005 Economic effects of income-tax law on investments in Australian agriculture - With particular reference to new and emerging industries