

**Submission to the  
Parliamentary Joint Committee on Corporations  
and Financial Services**

**INQUIRY INTO AGRIBUSINESS MANAGED  
INVESTMENT SCHEMES**

*Submission from John & Will Jeffreys, Delegate Station Pastoral Company,  
Delegate NSW*

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## Executive Summary

- For almost a decade now the warning bells have been ringing as to the flawed structure of MIS in all forms of agricultural investment. With recent collapses of the two main players in the MIS market, it is time for the government to act, abolish MIS and restructure the industry in line with every other OECD country.
- The ATO and ASIC need to review their lack of action and accountability as to the integrity of information provided to investors by promoters and the associated involvement of the financial services sector.
- Australian agriculture does not need “SCHEMES” to facilitate rural investment. Recent MIS collapses have only harmed sentiment for rural investment. There are many organizations currently investing in Australian agriculture based on sound enterprise profitability and capital growth.
- For the forestry industry, Australia needs a major restructure and mindset change. At present Australia’s timber industry is controlled by accountants, while environmental factors limit production in many areas. We need a realistic evaluation of our timber demands and existing resource estate. Industry models need to ensure they are market and production driven.
- It is pointless trying to encourage plantation forestry where it is not inherently viable. Like New Zealand and the UK, Australia needs to encourage forestry development with existing landholders and integrate with existing agricultural enterprises. These models have social and environmental benefits and do not encourage industrial scale expansion at the expense of other industries.

### 1. Business model and scheme structures of MIS:

Fundamentally MIS are flawed business models because of the following:

- **Do not promote sound investment decisions:** When MIS firms are selling products (i.e. woodlots, olive grove, etc) and the investors are primarily focused on buying something else (a tax deduction) adverse outcomes will occur.
- **Not market driven:** Economic fundamentals of supply and demand do not apply. Due to above, oversupply is inevitable within markets in which MIS operate (eg, pulp, wine, avocados).
- **Cost to the Australian tax payer:** Although the ATO attempts to remove itself from endorsing MIS products, by simply issuing a product ruling, they are investing on behalf of the Australian tax payer. The ridiculous situation with a woodlot establishment for example is that at a tax rate of 45c in the dollar the government is contributing \$4500 per ha (woodlot \$10 000 per ha). Genuine foresters will say that you can do this for considerably less and could well be closer to \$2000 per ha. There is no doubt that there are more cost effective methods of support.

- **MIS are inefficient structures:** No genuine business can afford to have the leaks that a MIS has and remain competitive in the world market. With advisors / brokers taking 10 %, promoters taking 30 – 40 %, there is not much chance of making a return, when at least half of your money never hits the ground.
- **Do not develop sustainable industries:** Although many/most of the MIS products in Australia will never generate a return to the investor (due to above), the idea is that they do. Given the supporters of MIS say that they are not Ponzi schemes, how do you ensure that one day in the future these industries will be self-sufficient. With a plantation for example, you would expect that part of the profits from the harvest would be used to fund the establishment of the next rotation. Not with MIS, any wealth generated is dispersed back to grower investors, leaving the long-term future of the industry in serious doubt.

## 2. Impacts of MIS rulings:

The 2020 Vision commissioned in 1997 was a flawed process from the very start. There was very little research into exactly why we needed to treble our plantation resource by 2020 and how regional communities would be impacted. Since that point the MIS sector has exploded, with overwhelming support from both federal and state governments. To compound problems for regional communities, local government planning has been removed from the process.

The previous Howard government made some small amendments to MIS in an attempt to reign in the sector. Incredibly in every situation the industry has got what it wanted. Brief summary as follows.

- **70% rule:** An attempt by Government to limit the profiteering by MIS co's. With very little follow up from Government after issuing product rulings, the reality is that only a small percentage of the grower investor dollar was ever hitting the ground. The industry trade off however, was that the deductibility of the initial woodlot fee for planting and establishment was to be spread for all costs over the life of the plantation. This essentially allowed business as normal with the balance of the 70% to be made up some time at the end of the growing period (ie 15 - 30 years later). Many government representatives that we have met with commonly quote the 70% rule as solving the ruthless profiteering, naively this was never the case.
- **12 – 18 mth pre payment rule.** Did have some effect with lessor timeframe, however what the industry wanted it got and current 18 mth rule stands. Removes risk for promoters and places pressure on land prices. Commonly individual promoters have raised 100 – 500 million pa. If they don't have the land to execute the projects (ie woodlots, almonds, etc) they have to hand cash back to investors, forgoing profits. Pressure mounts on land prices as this 18 month period draws to a close and promoters need to get their hands on land to avoid handing funds back. **It is interesting to note that the price paid for land is totally unrelated to enterprise profitability rather the profitability of the scheme.**

- No longer are MIS investments long term (part of the reason for allowing product rulings). Forestry investments may now be traded after 4 years, making them even more of a passive investment.

Other impacts of MIS on regional communities

- **Opportunity cost of prime agricultural land:** For forestry MIS in particular landscape change is dramatic, and virtually eliminates any other form of land use for a generation. Australian agriculture is very proactive and responsive to world markets. Through MIS the government has removed / limited many regional wealth creation opportunities (including tourism). The significant land use change has had many socio economic implications for regional communities.
- **Environmental opportunity cost:** Dramatic changes to hydrology and bio diversity in plantations. With enterprise profitability not applicable under MIS, many plantations have been established in highly marginal areas.
- **MIS addiction:** In many of the schemes where labour is intensive but enterprise profitability does not exist, the government has essentially created unsustainable regional economies through MIS.

### 3. Conflicts of interest with MIS

It is interesting how to view the conflicts of interest within MIS. The obvious conflicts of interest within a MIS structure is a) the promoters profits are unrelated to the enterprise profitability and b) the promoter retains ownership of land and water assets through the sale of MIS products.

However, due to the structure of MIS, at the point of sale of a MIS product, there appears to be less of a conflict for the stakeholders. The core business of the promoters and advisors is selling product units while the investor is primarily concerned with the tax effectiveness of the product. In each case the sale of a MIS product satisfy's the stakeholders objective.

As Alan Kohler, states:

*“It’s beautiful business because the companies are selling trees, but the consumers are buying something else...a tax deduction. A mismatch between sale and the purchase motivation means that the price is unrelated to the product.” (The Age, You Can’t See the Wood for the Deductions”, Alan Kohler, 26 June 2004.)*

The problem is that there are many in Australia that are not MIS promoters, financial advisors or tax burdened grower investors. The fact that enterprise profitability is not a primary consideration of MIS investment is totally unsatisfactory. This is a huge problem for ATO (Australian tax payer), competitors within the industries that MIS operate and other organizations competing with MIS for common resources (i.e. land and water).

#### **4. Commissions.**

It is essentially the oil that runs the success of a MIS business. The MIS model relies heavily on the network of financial advisors, accountants, etc to attract capital to facilitate the schemes. The lure of 100% investment deductibility for investors leaves fat in the system (unlike any other business structure) to attract financial advisors, accountants etc to sell MIS product.

Intrigued by the success of these salesmen, who were selling timber investments that I knew were highly questionable, I had to go and visit one. After a handful of glossy brochures with environmental fussy feelings and very little hard data, I was starting to question that capital growth of the investment (something obviously very few had ever done). I calculated the pre tax Net Present Value of the particular timber product he was selling which returned a NPV of around -\$1500 per ha on a \$8000 per ha investment. I questioned why I should invest and the answer was simple, tax effectiveness. Also, after questioning many times the projected timber growth figures (Mean Annual Increment, MAI) that he was selling were unrealistic, at the end of the meeting he asked me quietly “what does MAI mean?”.

#### **5. Accuracy of Promotional material.**

Carbon trading: Most of the schemes that I am aware of the promoter retains the right to at least 50% of any future profits from carbon trading.

Further, on issuing product rulings, there appears to have been very little effort if any by the ATO in researching information provided in the various prospectuses. Further, ASIC never appeared to question material put forward by the promoters. Both the ATO and ASIC have had numerous complaints by detractors of MIS over the years as to the lack of integrity of information provided to investors by promoters. Both the ATO and ASIC have serious questions to answer in light of the inevitable mess that we are just starting to enter, in relation to failed MIS projects.

The benefit for promoters of forestry MIS in particular is the timeframe lag of investment to reality (i.e. harvest 15 – 30 years time). A wheat MIS for example would not be as effective because if you charged double for sowing and only got half the yield you advertised, the investor is gone the next year along with all their mates. Forestry however you have 15 – 30 years before anybody has to start facing reality. Great Southern for example was able to top up returns to early investors in order to keep the new ones coming in.

## 6. Consumer education

You just have to look at the primary sales season (June) for MIS to realise that consumers were heavily focused on the tax effectiveness of the product rather than the production. My trip to the advisor put that to rest.

You have to realise that in good economic times, selling MIS is like selling pies at the footy. High professional salaries, potentially high capital gains tax bills from the share market, combined with all the recent hype around carbon trading. Any information on future markets, growth rates (MAI), etc were rarely discussed, and even if you wanted to find the info in the prospectuses it was a major challenge.

The notion that Australia has a large trade deficit in timber is misleading. Sure in \$ terms we have a trade deficit, however in tonnage, Australia has a trade surplus. If Australia is to address our trade deficit there needs to be a focus on value adding our resource. Table 1 illustrates that Australia currently exports large volumes of low value product such as woodchips and whole logs, however primarily imports value added products. The table shows that in 2007/08, even without woodchip exports Australia has an export surplus in timber and timber products.

**Table 1: Australian timber and timber products trade position (2007/2008)**

<u>TONNAGE</u>	EXPORT		Units	IMPORT		Nett surp / def
	value	%		Value	%	
Product						
Roundwood	1044	100	000m3	0.7	0	1043.3
Sawnwood	338.1	30	000m3	783	70	-444.9
Wood based Pannels	273.8	36	000m3	482	64	-208.2
Paper & Paperboard	790	30	kt	1847	70	-1057
Recovered paper	1285	99	kt	10.2	1	1274.8
Pulp	21.2	5	kt	388	95	-366.8
Woodchips	6166	100	kt	0.7	0	6165.3
<b>TOTAL</b>	<b>9918.1</b>	<b>74</b>		<b>3511.6</b>	<b>26</b>	<b>6406.5</b>

  

<u>VALUE (\$)</u>	EXPORT		Units	IMPORT		Nett surp / def
	value	%		value	%	
Product						
Roundwood	\$105	99	\$M	\$1	1	\$104
Sawnwood	\$120	20	\$M	\$492	80	-\$372
Wood based Pannels	\$108	28	\$M	\$284	72	-\$176
Paper & Paperboard	\$635	22	\$M	\$2248	78	-\$1613
Recovered paper	\$251	99	\$M	\$2	1	\$249
Pulp	\$15	5	\$m	\$285	95	-\$270
Woodchips	\$1072	100	\$M	\$2	0	\$1070
<b>TOTAL</b>	<b>\$2306</b>	<b>41</b>		<b>\$3314</b>	<b>59</b>	<b>\$-1008</b>

Source: ABARE 2009 (does not include railway sleepers and miscellaneous forest products).

## **7. Performance of the schemes**

Only in the early stages of evaluation, however it appears that many of the cries by opponents of MIS are turning to reality. No sound markets? Oversupply? High cost structures? Inflated returns? Australian tax payers to loose billions?? Michael Pasco indicates that the Australian taxpayer has dropped around \$4.6 billion on rural MIS this decade (*SMH, May 12, 2009*).

At present grower investors of failed MIS companies think they are ok because their products (trees, almonds, etc) are remain in the ground. It seems that many of these grower investors still don't get it. The notion that once a new responsible entity takes over, all the schemes will return a profit is incorrect. These investors can't change the fact that they have paid far too much to invest in forestry and agricultural schemes where solid markets may not exist. Although, particularly the timber industry attempts to keep production realities at bay, information is available as to the relative gross margins of many of the schemes. The problem to date is that the structure of MIS has not demanded such information and government authorities involved have not been interested.

## **8. Factors underlying the recent scheme collapses**

Liberal issuing of product rulings, MIS structure and corporate greed.

In relation to the two companies already collapsed, it appears that the huge revenue earning potential of MIS promoters proved too addictive. Primarily involved with timber plantations, the two companies (Timbercorp and Great Southern) expanded to non-forestry MIS to facilitate more outlets for their huge MIS revenue. More outlets meant more funds going through the system and more profit.

The Macquarie model of high gearing was used to facilitate expansion. The downturn in the global economy resulted in fewer professionals looking for tax effective investment, while a short-term halt to non-forestry MIS resulted in less sales. Although the remaining players in the market are also highly reliant upon MIS for their profit, the two gone already were 100% reliant. Also, many of the projects were structured with ongoing management fees, and it appears that as grower investors became anxious as to the stability of the parent companies fees were not paid.

The underlying fact is that MIS structures are not sound models for investment. As Michael Pasco states *"It's the biggest single scam in Australian financial history"* (*SMH, 12<sup>th</sup> May 2009*).

## **9. Impact of MIS on other related markets.**

We have seen the largest single land ownership change since the solider settlement scheme. Many rural communities have been decimated with a massive change to local demographics. Profitable business in these regions not operating under MIS have been unable to expand and grow given unrealistic competition from MIS organizations. In



many cases once in a lifetime opportunities have been lost, with many looking to get out of the industry doing so during this MIS wave. It is doubtful that the damage caused by this wave to regional communities will ever be repaired.

## **12. Legislative change**

Simple, get rid of MIS just like every other OECD country has done. Australian agriculture does not need “SCHEMES” to facilitate rural investment. The notion that if there is no MIS there will be no investment in rural Australia is rubbish. Recent MIS collapses have only harmed sentiment for rural investment. There are many organizations currently investing in Australian agriculture based on sound enterprise profitability and capital growth.

For forestry we need an industry that is able to support itself, unlike the current reliance on MIS. We need a realistic evaluation of our timber demands and existing resource estate. The current MIS model encourages plantation expansion at the expense of other forms of land use. Forestry enterprises need to be driven by markets and enterprise profitability.

The UK model is one that we have tabled many times, and like most other concerns raised has fallen on deaf ears. Such a model offers assistance to landholders to cover a % of the planting and establishment costs and provides tax advantages to processors of the product to encourage value adding of the resource. Through this model, plantations are integrated into the existing landscape, reducing environmental issues and enabling more efficient land use.

In 1987 New Zealand had a major restructure of the forestry industry and removed many of the incentives that are currently plaguing the MIS sector in Australia. Today, New Zealand’s forestry industry is highly production driven and has a value added focus. Grant schemes assist existing landholders to establish plantations within their existing landscapes, while external investment is still used to invest in forestry companies. External investors become shareholders of the companies that manage plantations and may receive some tax advantages related to the companies direct forestry expenditure (not notional woodlot units). New Zealand’s Ministry of Agriculture and Forestry is very active in overseeing production (i.e. strict code on suitable sites) and evaluating forecast and actual harvest outcomes. There is also a strong government support for value adding the resource.

The following information comes from a document by the New Zealand Ministry of Agriculture and Forestry headed *The Impact of Incentives on the Development of Plantation Forest Resources in New Zealand (August 2002)*.

The changes of 1987 were described as follows:

*“This was a remarkable step. The failure of government policy and incentives are when they continue to directly support industries that have reached a stage of self-sustained*

*growth. That is not only a wasteful use of tax payers' money, but also leads to inefficiency in the industry."*

*"It is apparent that any move to restore subsidies or other market distorting mechanisms would be firmly opposed in a desire to continue to operate under fair and equitable economic and regulatory environments".*

Further their conclusions from this period with respect to incentives for plantation forestry are as follows:

- *government involvement in plantation forest ownership had played a major role in the development of an internationally competitive industry, but once established, continued involvement was not necessary;*
- *regardless of government's involvement in plantation forest ownership, it retains a role in ensuring appropriate planning and infrastructure development are undertaken;*
- *corporate forest investment is motivated by financial returns and subsidies were not required, provided a neutral investment environment was in place;*
- *subsidies were not required to maintain the plantations once established because the economics of the business were sufficient to ensure that the vast majority of forest investors now replant following harvesting;*
- *smaller-scale forest investors are often influenced by media analysis of the industry and may be motivated by a range of financial, environmental and social factors, so any incentives must be carefully targeted;*
- *taxation regimes have a significant impact on investment in plantation forestry, and a stable and equitable regime is important;*
- *direct financial incentives mask the real viability of plantation forestry or any other business;*
- *access to independent and objective information about plantation forestry is a valuable incentive for encouraging new investors;*
- *profitability will ultimately determine the level of investment i.e. it is pointless trying to encourage plantation forestry where it is not inherently viable.*

**Reference:**

New Zealand Ministry of Agriculture and Forestry, *"The Impact of Incentives on the Development of Plantation Forest Resources in New Zealand"*. David Rhodes and John Novis, 2002

Sydney Morning Herald, *"Australia's biggest scam comes crashing down"* Michael Pasco 12<sup>th</sup> May 2009

The Age, *You Can't See the Wood for the Deductions"*, Alan Kohler, 26 June 2004.

ABARE: *Forest & Wood statistics 09*