



## **Inquiry into Agribusiness Managed Investment Schemes**

The following submission is made to assist the Inquiry with the views of an experienced forester who has frequently been involved in forestry Managed Investment Schemes (MIS) as an Independent Expert forester. The author is a Registered Professional Forester (RPF™) with 34 years of post graduate experience in Australian forestry. Almost all of that experience has been in the private sector. The roles in which the author has been involved are set out in Appendix 1.

We are strong advocates of privately funded and managed plantation forestry. Soundly managed plantation forestry will bestow many economic, social and environmental benefits to Australia.

### **1. Business Models And Scheme Structures Of MIS;**

### **2. The Impact Of Past And Present Taxation Treatments And Rulings Related To MIS;**

We believe that changes to superannuation in approximately 2006 made superannuation generally a more attractive and tax effective investment than the tax deferral schemes such as forestry MIS. This resulted in a significant reduction in new investments in MIS.

The requirement for 70% Direct Forestry Investment does not appear to have a major impact on forestry MIS. Perhaps this is because 30% of the initial fee were more than adequate to cover non-forestry fees such as administration and marketing expenses.

The tax advantages of forestry investments are generally reasonable. It is the nature of forestry that crop establishment expenses are incurred many years before the crop revenues. In most instances this is a major disincentive for forestry because not many people find it attractive to lock up their investment for many years before a return. However, the tax deductibility of crop expenses in forestry, as in other agricultural crops, appeals to investors with a high current marginal tax rate expecting their tax rate to fall over the term of the crop. They effectively defer a tax liability and may meet it when their marginal rate is lower.

This general reasonableness was stretched by artificial arrangements whereby investors borrowing the funds, claim the interest on the loan and repay (part of) the loan with returned taxes.

Many of the older MIS schemes involved annual payments of land rent and plantation maintenance. MIS managers and investors found it more practical to make a single payment because they were uncertain of future funds availability for investment and therefore unable to commit to the normal forestry crop cash flow requirements involving annual maintenance casts. Single payment arrangements in which all crop expenses were paid up front or taken out of project proceeds do not reflect the cash flow of a forestry project.

Forestry is a relatively long term investment. In economic terms, interest charges accumulate to money outlaid. Expenses early in the investment accumulate many years of interest so it is prudent forest management to minimise expenses early in the cycle. MIS forestry frequently moved away from this principle because investors were unable to commit to annual contributions. A single payment mechanism was more popular and practical for retail investment. In theory, the funds invested up front could have been held in escrow accruing interest and dawn upon when required for annual forestry expenses. In practice, the up front fees may have funded current expenses including generous management, administration and marketing fees and opulent forestry expenses.

This resulted in a potential situation when new investment cashflow declined there was insufficient funds available to cover expenses.

### **3. Any Conflicts Of Interest For The Board Members And Other Directors;**

### **4. Commissions, Fees And Other Remuneration Paid To Marketers, Distributors, Related Entities And Sellers Of MIS To Investors (Including Accountants And Financial Advisers);**

### **5. The Accuracy Of Promotional Material For MIS, Particularly Information Relating To Claimed Benefits And Returns (Including Carbon Offsets);**

The Product disclosure Statements (PDS) are required to provide sufficient information for a reasonable person to assess the merits of the schemes. This information has sometimes been provided in a form which is not obvious for inexperienced assessors to process. For example, it is common for forestry MIS to promote a woodlot which was part of one hectare or more than one hectare and even a variable area projected to produce a fixed quantity of wood. Comparison between alternative investments would require the projected productivity to be expressed in a common unit (for example, tonnes per hectare). Measurement units are often confusing. Wood may be expressed as cubic metres, green metric tonnes or Bone Dried Metric Tonnes within the same PDS. This has potential to create confusion to readers unless they are familiar with the terminology.

By way of a case study, we reviewed a 2008 PDS which received an ATO Product Ruling and attracted significant investment . Using information in the PDS and looking only at the eucalypt portion, we surmised that the proposal was to invest \$11,400 per hectare with an expectation that returns in 8 to 12 years would be at least \$9,000 per hectare in 2008 values. As well as the dubious returns a number of risks (agricultural, market) were outlined in the PDS. The amazing aspect of this is that, in spite of the information presented in the PDS, presumably financial planners and accountants recommended this investment opportunity to their clients for it to be successful. This suggests that the advisors did not understand the PDS and did not seek independent professional forestry interpretation of the PDS before recommending the investment. It suggests that some advisers are making recommendations, not on the merit of the investment to their clients but on some other basis which is likely to be commissions payable and other benefits to the advisor.

### **6. The Range Of Individuals And Organisations Involved With The Schemes, Including The Holders Of The Relevant Australian Financial Services Licence**

#### **The role of foresters**

Foresters are involved in forestry MIS as managers and as Independent Experts as per ASIC policy. To ensure high standards of practice would require foresters to be qualified and/or licensed to practise recognising university and technical training as well as experience to achieve levels of qualification.

The silvicultural management of the MIS plantation forests are generally of a high standard. There are a number of exceptions to this particularly when smaller enterprises and *alternative* species are involved. We have observed and reported on a number of projects which involved species which had a limited successful history in Australian forestry. In most cases early plantations of these new species met with failure or limited success. For example, MIS schemes involving Casuarina and Paulownia species have met with limited success. Even blue gum was developmental when the first investment schemes promoted there potential.

MIS pine and blue gum forestry has invested extensively in high quality research which has generated knowledge, germplasm and technology to the benefit of all forestry.

## Independent Foresters

The role of Independent Forester should be taken very seriously. It is a much under-recognised role by the public and many of the plantation managers. It is vitally important to retail investment in plantation forestry that sound forestry is practiced by managers. The competent and experienced Independent Forester will, as appropriate, be able to provide feedback to managers if there are areas which can be improved while building confidence for the investors that their interests are well protected.

The Independent Forester should be responsible to the Compliance Committee. The reporting lines of the Independent Forester should not be to the marketing sections of the project manager. It is also preferable for the Independent Forester to avoid extensive involvement in Project management so that he is not party to any problem which may compromise independence.

## 7. The Level Of Consumer Education And Understanding Of These Schemes;

## 8. The Performance Of The Schemes;

It is impossible to generalise on the performance of forestry MIS schemes. We have observed and reported on the forestry aspects of many good and excellent schemes, some schemes which we expected to be good but the outcomes were disappointing and others which were always high risk or poorly managed. As stated above, *alternative* species and projects in novel regions are high risk with more variable results.

## 9. The Factors Underlying The Recent Scheme Collapses

## 10. The Projected Returns And Supporting Information, Including Assumptions On Product Price And Demand

Hardwood plantation forestry can be successful. The direct costs of establishment of hardwood plantations can be \$1,500-\$3,000/ha, with annual maintenance costs of \$30-\$60/ha/year. Growth rates vary widely with rainfall and soil suitability, from less than 5 tonnes/ha/year to more than 35 tonnes/ha/year. The regional average is in the range 15-25 tonnes/ha/year. Stumpages (farm gate price net of harvesting costs) vary with distance from port and yield/ha have been up to \$58/tonne and in the Albany region would average \$35-40/tonne. Therefore revenues can exceed \$20,000/ha although the average would be around \$7,000-\$9,000/ha.

We summarised critical elements of the Great Southern Limited Fibre Project 2008 which fairly clearly sets out the costs and reasonable revenue expectations. (Noting that ASIC does not allow forecasts to be made in PDS anymore). Brief review of this PDS revealed an investor could reasonably expect returns of \$9,079/ha after 8 to 12 years.

**Table 1: Analysis of the Great Southern 2008 Future Forestry Investment PDS (Eucalypts only)**

Item	Value (all net of gst)	Value/hectare	Source in PDS
Application fee	\$2,850/0.25 ha woodlot	\$11,400	p3, 21
Volume expected (Vol)	15-35 m3/ha/year 200 m3 8-12 years avg.	average > 200 m3/ha	p22, 70
Chip Price FOB (CP)	\$189.40/BDMT		p27
Basic Density (BD)	550 kg/m3		p27
Production Losses (PL)	5.5%		p27
Gross Proceeds	Vol*BD*CP*(1-PL)	\$19,688	p26
Production costs	\$48/gmt	\$ 9,600	p27
Net Proceeds		\$10,088	
Management fee	2.5% of net proceeds	\$ 252	p38

Rent fees	7.5% of net proceeds	\$ 757	p38
Return to grower		\$ 9,079	

On the basis of experience around Albany, the PDS appears to be reasonable. From the above summary, the PDS sets out information showing the project after 8 to 12 years to return less than the investment on a before tax basis.

## **11. The Impact Of MIS On Other Related Markets; And**

## **12. The Need For Any Legislative Or Regulatory Change.**

### ***Conclusion***

It is of particular concern that the currently situation will inevitably erode public confidence in MIS forestry and forestry in general. This will result in reduced public investment in plantations. This is unfortunate because well managed forestry can be a wealth creating investment with benefits to the environment and communities as well.

There are particular issues with MIS schemes which warrant revision including the quality of advice provided to potential investors and the premiums over costs charged by management companies. In particular, we are concerned about conflicts of interest of advisors receiving large commissions for particular investment products.



## ***Appendix 1: Independent Forester roles undertaken by Plantall Forestry Consultants***

Plantall Forestry Consultants prepared Independent Forester's reports for the following projects:

Project Name	Year	ARSN	Manager
Australian Oak Project	2001	096 749 665	Plantation Equity Services
ITC Pulpwood Project 2002	2002	099 062 003	ITC Project Management Limited
ITC Solidwood Project 2002	2002	099 061 980	ITC Project Management Limited
ITC Sandalwood Project 2002	2002	099 062 067	ITC Project Management Limited
ITC Pulpwood Project 2003	2003	103 252 339	ITC Project Management Limited
ITC Solidwood Project 2003	2003	103 252 286	ITC Project Management Limited
ITC Sandalwood Project 2003	2003	103 252 151	ITC Project Management Limited
ITC Pulpwood Project 2004	2004	108 058 439	ITC Project Management Limited
ITC Sandalwood Project 2004	2004	108 058 288	ITC Project Management Limited
ITC Pulpwood Project 2005	2005	112 286 334	ITC Project Management Limited
ITC Sandalwood Project 2005	2005	112 286 254	ITC Project Management Limited
ITC Pulpwood Project 2006	2006	117 764 673	ITC Project Management Limited
ITC Sandalwood Project 2006	2006	117 764 182	ITC Project Management Limited

In addition, Plantall Forestry Consultants drafted an Independent Forester's report for Queensland Paulownia Forests Limited (QPFL) which was not finalised before QPFL was placed in the hands of receivers.

Annual Growers' reports on the basis of plantation field inspections were prepared for the above ITC Projects from 2002 to 2006 inclusive plus the following:

Kimseed Forestry Limited and Alliance RE Limited from 2001 to 2007. This required annual reports on the Kimseed Eucalypts Esperance 2000 Project (ARSN 092 405 797) plus a number of other non-PDS projects and private holdings managed by Kimseed Pty Ltd. In addition, we provided inventory and limited plantation management advice to Kimseed who did not employ or engage any other professional forestry advisors.

APT Project Management Limited covering 13 projects from 1992 to 2001 from 2002 to the present (ongoing). In addition, the projects up to and including 1999 required the Independent Forester to assess the funds required for future plantation Maintenance and Expenses.

QPFL covering 11 projects for 2006 only.