

AMURI HILLS FOREST PARTNERSHIP

Forest & Joint Venture Particulars

+ 2018 Annual Report

Partnership Particulars

Year Established	1995
Number of Partners	48
Main Assets	219 hectares of plantation forest in 5 stands
Management Committee	Warren Forestry Ltd, J McCaul, GTG Kingston, DS Lawrence
Forest Manager	Warren Forestry Ltd
Accountants	Bartram's
Bank	ANZ Bank
Independent Forestry Consultant	Patrick Milne, NZIF Registered Consultant
Supervisor	Covenant Trustee Services Ltd

Forest & Joint Venture Particulars

Nature of Business

The sole business activity of the Partnership is to grow and then harvest a plantation forest in five forest stands on land provided pursuant to Joint Venture Agreements ('JVAs') by three landowners in North Canterbury. The JVAs provide Forestry Rights, which are registered on the landowners' titles, enabling and requiring the Partnership to establish, tend and manage forest regimes for one rotation on the land. At harvest, net forest proceeds are shared between the partnership and land owners with the split ranging from 73/27% to 85/15%. That split is fixed from the start by agreement and is arrived at from an assessment of the forest sites' merits, principally the cost of forest establishment and silviculture, likely forest growth & yield, and likely harvest costs. The joint venture ends at harvest or sale of the forest and the Partnership is dissolved.

Outline of Land, Forest Location, Species, Regimes & Joint Venture Shares

Glens of Tekoa: 7,800ha sheep & beef farm north of the Hurunui River inland of Culverden, North Canterbury foothills owned by W & G McRae.

GT1: 22ha Radiata pine (seed lot GF17 seedlings) planted in 1995; 20ha clearwood regime, i.e. high pruned and thinned, to 330 sph (stems per ha); 2ha framing regime, i.e. unpruned. Expected harvest is about age 30 in 2025, but could be a few years earlier. Partnership/Landowner shares: 73/27%.

GT2 & GT3: 20ha & 39ha Douglas-fir (seed lot Eyrewell) planted in 1995, framing regime, unthinned and averaging about 1000 stems per hectare, which is high but the Consultant's advice is not to waste thin it, as that would not be cost effective. Expected harvest is about age 40, which would be 2035. However there could be a production thinning at some point if it becomes feasible. Shares are 80/20% & 85/15%.



GT2, Jan 2018

Douglas-fir aged 22.5

Leslie Hills: 3,440ha sheep & beef farm north of the Waiau River, south of Hanmer Springs, North Canterbury foothills owned by E Rutherford and family.

LH1: 110ha Radiata pine (seed lot GF17 seedlings) planted in 1995; 93ha clearwood regime, with 68ha high pruned & thinned to 340sph; & 25ha part pruned, thinned to 500sph; 19ha framing regime. Expected harvest is about age 30 in 2025, but could be a few years earlier. Shares: 79/21%.

Hopefield Station: 2,000ha sheep & beef farm northeast of Waiau, North Canterbury foothills owned by M Satterthwaite.

HF2: 27ha Radiata pine (seed lot GF17 seedlings) planted in 1995; all clearwood regime, thinned to 340sph. Expected harvest at about age 30 in 2025, but could be a few years earlier. Shares: 76/24%

Annual Report General & 2018 Specific Information

Forest Growth & Health: All was well in 2018. The five forest stands are healthy and were not affected adversely by any weather or climatic events. They are growing vigorously.

Insurance & Valuation: The forest is insured for fire and storm losses, clearance and replanting costs, earthquake and Public Liability, plus for claims (NB: firefighting costs are now covered by the state). All cover has excesses or upper limits judged as reasonable by the Forest Manager in consultation with the Independent Forestry Consultant. It is a judgement call choosing the level of cover. Both cost and risk are relevant. The insurer does not give us a discount for the lower risk gained by having the forest in separate stands, mostly bordered by grazed farmland, in the ley of hills and not publicly accessible.

Also the Douglas-fir is lower risk. So it is tempting to under insure that, but we don't.

The policy is tendered annually by forest management and consultancy firm PF Olsen Ltd, the largest forest manager in NZ, as a group insurance plan for its many clients.

As part of the insurance contract service, Olsens provide a free valuation based on area, location, age, species and the regime of each individual forest stand.

As this value is 'broad brush' we compare it to a value arrived at by the Forest Manager and Independent Forestry Consultants' valuation calculator. This uses actual forest data which specifically produces forest stand values for the Partnership's forest, based on a growth model. This is straight forward to update annually.

The method used, is the same as Olsen's but from more detailed and specific information about our forest stands. It uses discounted cash flow from a calculation of forecast net harvest proceeds. Getting to that figure involves making several significant assumptions or 'judgment calls', the discount rate being the most significant. It is regarded in the industry as the best method for mid-rotation valuation even though it is by its nature quite theoretical, and the further out the more so. Forests are unusual and quite variable assets and there are insufficient sales of similar immature forests to give forests a market valuation, which if it existed would be better.

The insurance year runs from June to May so the sum insured is set in May. The insured value is an agreed value with the insurer. It does not have to be exactly Olsen's or our forest value. It just has to be 'within acceptable boundaries' so probably could easily be 40% higher or lower, which would of course be reflected in the premium. Note the big jump in our valuation at the end of 2018 (as occurred the previous year too). This is due to increased log prices and static costs, plus of course another year's growth and being a year closer to harvest. We will look at it again in May 2019 to set the values the forest stands are covered for from June 2019 to May 2020.

Actual sum insure (total fire cover):	\$4,262,670
Olsen's Insurance value for 2018/19:	\$4,056,855
Forest Valuation as at 31/12/17	\$3,694,488
Forest Valuation as at 31/12/18	\$4,699,044

Wind storm cover (the maximum offered)	\$1,000,000
Public liability	\$3,000,000
Earthquake	\$250,000
Clearance and replanting cover	\$3,500 per ha
Claims costs cover	\$10,000

The Emissions Trading Scheme ('ETS'). In 2010 the Partnership's forest stands were registered in the ETS. The Partnership received carbon credits, known as NZUs, until leaving the ETS in 2014 and returning cheap European credits to the government instead of our NZUs. That was done to avoid having to return all our NZUs at harvest, as the rules would otherwise perversely require. That turned out to be a significant windfall and we have received enough cash by selling down our NZUs gradually to cover all outgoings for many years. Although most are sold now, we still have around \$160,000 worth at current value.

The ETS continues, and is still undergoing a long review for reforms which should keep the NZU price up and be favorable to forestry. But that was what we were told previously and it certainly was not true, with some exceptions such as our 'windfall'. Still the government may get the settings right in due course.

In December 2017 our application to rejoin was largely accepted. This time MPI did not approve some forest area as they were not convinced it was not forest land in 1990, which is a requirement. This is possibly incorrect so we may seek a review in due course.

Joining in 2017 means we now have all credits earned from 2013 to 2017. There is no longer an arbitrage opportunity but who knows what others may arise. It remains an option for us to take an income from carbon credits and then see what happens as we approach harvest age. However that would require a new agreement with our landowners which may not be feasible. But we will seriously look at that option, especially for the longer rotation Douglas-fir crop. In theory we could earn as much from carbon credits as log sales, and delay harvest or even have both. Any changes to this investment will require investor and landowner consent and is unlikely unless it is low or no risk.

Forest Management and Partnership Administration. Warren Forestry Ltd carried out all forest and partnership management work for both parties to the joint venture until late 2016. Important forest matters were and still are decided in AGMs or by the Independent Forestry Consultant pursuant to the Partnership's Deed of Participation and Joint Venture Agreements.

In November 2016 the Partnership updated its Deed and revived its Management Committee, elected by the Partners, to be its official Manager. So the Partnership is legally self-managing now which means it is no longer regulated as a 'Managed Investment Scheme' by the Financial Markets Authority. This saves significant accountancy costs and unproductive management work. Warren Forestry Ltd remains Forest Manager and now is Partnership Administrator.

Supervision & Audit. The Statutory Supervisor became 'the Supervisor' in 2016 following the change to the Partnership's Deed of Participation, with effectively the same role and continues to hold the Forestry Rights and any NZUs as trustee. Audit of the accounts is no longer required by law so the Partnership is able to elect to dispense with audits if it thinks they serve little or no purpose, and so are an unwarranted expense. It did so in 2018.

Markets for Logs & Forests - General Comment. In 2018 log markets were consistently good and ended the year significantly higher than 12 months before. Chinese demand has held up well and not been volatile. The log market is almost entirely export dependent, since 90% of NZ production is exported either as logs (60%) or product processed to some degree. The value of the NZ dollar is another significant factor and that has been down a bit. Shipping costs are still low and fuel costs which affect harvest and transport costs are lowish. Harvest and transport is still relatively costly so we hope new technology will lower these in future, and or log prices rise even further. Overall the effect has been to significantly increase the forest valuations as at 31 December 2018, as they are based on expected net harvest revenue, discounted back to now.

Comparison of Budget to Costs

Actual Expenditure compared to the 2018 Budget		\$
Operating costs	Budget	Actual
Accountant's fees	2,000	1,748
Bank charges	-	70
Contingency	2,000	-
ETS forest plots by contractor	4,250	-
ETS associated work	850	800
Forestry Consultant	200	-
Insurance	9,000	12,125
Management & Administration by WFL	7,750	7,749
Supervisor: annual fee	1,500	1,500
Subscriptions	-	115
Track maintenance	500	450
	28,050	24,557

Notes:

Accountancy & (No) Audit. No longer do we have any audit costs, and this has lowered accountancy costs.

ETS forest plots by contractor. This has been in the last two budgets but not taken place so we have removed it from 2019. It may be done in 2019 or later if we are advised it is worthwhile. It should be cost effective work since it results in us gaining extra carbon credits, as our forests are above average, and average is the default level we will be awarded without measurement. However we await the ETS review before going ahead as it is possible it may not turn out worthwhile.

Management & Administration by WFL: This is a fixed fee set annually to cover all time cost and mileage for all likely routine work. We work it out from looking at the previous year's hours and mileage for all six of our forest investment partnerships and making any adjustment for likely changes. Then we apportion the total to the partnerships based on forest area, and adjust them again up or down depending on any expected extra work for a particular partnership.

Insurance: We decided to increase cover significantly, especially for the Douglas-fir since there was a continuing strong increase in forest value due to log price increases. Also, fire appears to be an increasing risk. The Budget was done earlier in the year.

Charles Etherington
Warren Forestry Ltd
Forest Manager & Administrator for the Partnership's Management Committee
February 2019

PTO for some pics...

Remember 'that tree' on Leslie Hills? I did a series of shots of it over the years. Here it was approaching two in 1997. And below that, 21 years later. It has more wrinkles than I do!



Aug 2018

