TRIPLE RIDGE FOREST PARTNERSHIP

Forest & Joint Venture Particulars
+ 2018 Annual Report

Partnership Particulars

Year Established	2000
Number of Partners	47
Main Assets	262 hectares of plantation forest in 5 stands
Management Committee	G McVicar, A McKenzie, M Tillman
Forest Manager	Warren Forestry Ltd
Accountants	Bartram's
Bank	ANZ Bank
Independent Forestry Consultant	Patrick Milne, NZIF Registered Consultant
Supervisor	Covenant Trustee Services Ltd

Radiata pine at Leslie Hills (LH3), Jan 2019

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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 72/25% to 87/10%, with 3% going to Warren Forestry Ltd. 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.

However in one case rental was paid for three years significantly reducing the Landowner's share. The joint venture ends at harvest or forest sale 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.

GT6: 24ha Radiata pine (seed lot GF19 seedlings) planted in 2000; framing regime, i.e. not pruned and high stocking maintained. Expected harvest at about age 30 (2030). Partnership/Landowner shares: 80/17%.

GT5: 48ha Douglas-fir (seed lot Hebo) planted in 2000, framing regime i.e. unpruned. Much of it will be thinned to waste in 2017. There is the possibility of production thinning around age 25 to be considered if feasible. Expected harvest at about age 35 to 40. Shares: 77/20%.

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.

LH3: 167ha Radiata pine (seed lot GF19 seedlings) planted in 2000; 141ha is high pruned and thinned to 330sph and the rest is an unthinned framing regime. Expected harvest at about age 30 (2030) or perhaps a few years earlier. Shares 72/25%.

Kalimera: 922ha Perendale sheep stud farm on the north bank of the Conway River, at Hundalee, North Canterbury, owned by T & S Anderson.

KM1: 19ha Radiata pine (seed lot 50/50 GF17 seedlings/GF28 cuttings) planted in 2000; all clearwood regime, thinned to 320sph. Expected harvest about age 29 (2029). Shares 87/10% (high rental was paid for first 3 years). Also 3.3ha *Cupressus macrocarpa* (mix of seedlings and cuttings); all pruned and part thinned in 2015/16 to 550sph.

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 insured (total fire cover):	$3,150,100
Olsen's Insurance value for 2018/19:	$3,173,184
Forest Valuation as at 31/12/17	$3,062,348
Forest Valuation as at 31/12/18	$4,125,179

Wind storm cover (the maximum offered)	$1,000,000
Public liability	$2,000,000
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 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 $90,000 worth at current value. That will cover at least the next three years expenses.

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 created 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	-	97
Contingency	2,000	
ETS forest plots by contractor	4,500	-
ETS associated work	850	800
Forestry Consultant	200	
Insurance	8,000	9,394
Management & Administration by WFL	7,900	7,900
Supervisor: annual fee	1,500	1,500
Subscriptions	-	115
Thinning Douglas-fir	30,000	14,450
Track maintenance	700	600
	57,650	36,604

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.

Thinning Douglas-fir: We have more of this to do, *perhaps* and will seek direction from our Independent Forestry Consultant. This work is expensive, can be dangerous and it is very hard to find good contractors. But actually it is not always vital at all as this crop will 'self-thin' if we don't do it. So there is a decided trend in the sivicultural world to only thin high stocked and high growth rate crops. The area thinned was that and we have more like it, but need to look at it again to decide if it really warrants the cost and difficulty of thinning.

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

PTO for some pics…

When we were young. Same forest as page 1, at Leslie Hills in 2001, aged 1.5
Of course I haven't changed at all.