SEVENTH FOREST PARTNERSHIP

Forest & Joint Venture Particulars
+ 2019 Annual Report

Partnership Particulars

Year Established	2003
Number of Partners	36
Main Assets	160 hectares of plantation forest in 4 stands
Management Committee	H Chapman, S Daly, G Horne
Forest Manager	Warren Forestry Ltd
Accountants	Bartram's
Bank	ANZ Bank
Independent Forestry Consultant	Patrick Milne, NZIF Registered Consultant
Supervisor	Covenant Trustee Services Ltd

Chimney Creek forest stand CC2 (Marlborough), Oct 2018 *Pinus radiata* aged 15.5

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Nature of Business
The sole business activity of the Partnership is to grow and then harvest a plantation forest in four forest stands on land provided pursuant to Joint Venture Agreements ('JVAs') by three landowners in North Canterbury and one in Marlborough.

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 being 75/20% and 5% 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 and yield, and likely harvest costs. The joint venture ends at harvest and the Partnership is dissolved.

Outline of Land, Forest Location, Species & Regimes

Chimney Creek: 800ha sheep, beef & cropping farm in the Waikakaho Valley, north of the Wairau River, inland of the Picton road, Marlborough. Owned by P & M O'Sullivan.

CC2: 57ha Radiata pine (seed lot GF plus aged cuttings, selected for wood qualities) planted in 2003; All of it is a framing regime, i.e. unpruned and was thinned in 2014.

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

GT14: 15ha Radiata pine (seed lot GF Plus aged cuttings selected for wood qualities) planted in 2003; the better half is a clearwood regime, i.e. pruned & well thinned (Jan 2017); the rest a framing regime i.e. unpruned and lightly thinned (Jan 2017). Expected harvest at about age 30 (2033).

Gola Peaks: 2,300ha sheep & beef farm south of the Waitohi River, inland of Hawarden, North Canterbury foothills, owned by M & S Rutherford.

GP1: 45ha of Douglas-fir (seed lot Tramway) planted in 2003 at 1,370shp, as a framing regime i.e. unpruned, unthinned as yet. We looked at waste thinning it in 2016, but decided best not to as there would be no net benefit. Some of it may feasibly be production thinned at some point. Expected harvest by age 40 (2043).

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

HF3: 47ha Radiata pine (seed lot GF plus aged cuttings, selected for wood qualities) planted in 2003; all clearwood regime, thinned in 2013. Expected harvest at about age 30 (2033), or a few years earlier is possible depending on the log markets.

Approximately 4ha was damaged by subsidence due to an earthquake in November 2016. The extent to which this area is lost is yet to be fully assessed for an insurance claim.

Annual Report

General & 2019 Specific Information

Forest Growth & Health: All was well in 2019. The four 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 costs (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 arguably be better.

The insurance year runs from June to May so the current sum insured was set in May 2019. The insured value is an agreed value with the insurer. It does not have to be Olsen's or our forest value. It just has to be acceptable to the insurer. Olsens value is much lower because a) their Douglas-fir valuation settings are for a longer rotation and b) they use a higher discount rate. Both make a big difference. So we explained this and our selected figures were accepted.
At time of writing forest values have slumped, so we may have about the right insured value! We shall review our growth model and valuation settings by May 2020 to increase confidence in it.

Actual sum insured (total fire cover):	$2,460,750
Olsen's Insurance value for 2019/20:	$1,460,946
Forest Valuation as at 31/12/18	$2,741,831
Forest Valuation as at 31/12/19	$2,942,251

Wind storm cover (the maximum offered)	$1,000,000
Public liability	$5,000,000
Earthquake	$250,000
Clearance and replanting cover	$3,500 per ha
Claims costs cover	$10,000

Insurance cost June 2019-May 2020	$7,806

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 cheaper European credits to the government instead of our NZUs. That was done to avoid having to return these first five years of NZUs at harvest, as the rules would otherwise require. That turned out to be a reasonable windfall and we received enough cash by selling down our (old) NZUs yearly to cover all outgoings for a few years.

In December 2017 our application to rejoin was largely accepted for GP1 and HF3 but not CC2 (GT14 is not eligible as it's a 2nd rotation). This time MPI were not convinced CC2 was not forest land in 1990, which is a requirement. This is possibly incorrect so we will try again in 2020. Mostly reapplying will fail but we should try, especially for the landowners, as it affects the second rotation ETS options for them very significantly indeed.

A long review of the ETS ended in 2019 and significant changes have been announced which come into effect in 2021. Unfortunately, the new rules which allow up to half of the credits received to be retained beyond harvest, so long as there is a replant, do not apply to any of this Partnership's forest stands. They are too old. However, there is a new 'Permanent Forest' option which JV forest owners, could both benefit from.

Joining in 2017 meant we got all credits earned from 2013 to 2017, and then indefinitely. There is no longer an arbitrage opportunity and it is unlikely to occur again. It remains an option for us to take an income from these (new) 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 and advise on that option. In theory we could earn as much from carbon credits as log sales, and delay harvest or even have some of both. Any changes to this investment will require investor and landowner consent at a very high level, which is unlikely unless it is very low or no risk.

Forest Management and Partnership Management & Administration. Warren Forestry Ltd remains Forest Manager and Partnership Administrator for the Partnership's Manager which is its elected Management Committee. Important forest matters are ultimately decided in AGMs with advice from the Manager & Independent Forestry Consultant pursuant to the Partnership's Deed of Participation and Joint Venture Agreements.

Supervision. The Supervisor is Covenant Trustee Services Ltd, formerly our Statutory Supervisor, with largely the same role and continues to hold the Forestry Rights and any NZUs as trustee.

Markets for Logs & Forests - General Comment. In 2019 log markets were consistently good until June when there was a big drop due to oversupply. But most, although not all that fall was recovered by December. Chinese demand has been strong and stable for a few years. 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 as are shipping costs. Both changed little in 2019.
Diesel costs affect harvest and transport costs which are still relatively expensive, so we hope new technology will lower these in future, and or log prices rise further to offset them.
Overall there was no prices/costs increase in forest values in 2019. So the value increase shown above is from being one year closer to harvest, as net harvest revenue is discounted back to now.

Comparison of Budget to Costs

Actual Expenditure Compared to Budget	Budget 2019	Actual 2019	Actual 2018
Operating costs			
Accountant's fees	2,000	1,940	1,748
Bank charges	-	120	117
ETS associated work	500	500	800
Insurance	6,500	7,806	5,879
Management & Administration by WFL	5,900	5,900	6,251
Supervisor: annual fee	1,500	1,500	1,500
Subscriptions	-	-	115
Track maintenance	750	400	1,000
Travelling expenses	-	-	147
	17,150	18,166	17,557

Notes:

ETS Associated Work: As referred to on page 4, the ETS keeps us on our toes with increasing complexity and changes. We engage an expert to advise us and attend government briefings etc. It is worth it for the Partnership, as was proved in the early days and we still think there is more to come.

Insurance: We decided to increase cover again significantly, 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.

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.

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

February 2020

PTO for a Google Earth picture from August 2018 of the Gola Peaks Douglas-fir stand GP1 in the foreground. In the background are the three stands on Mt Whitnow Station belonging to another of our partnerships.


Untitled Map
Write a description for your map.
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