# SIX HILLS FOREST PARTNERSHIP
## Forest & Joint Venture Particulars
## + 2019 Annual Report

## Partnership Particulars

| | |
|---|---|
| Year Established | 1996 |
| Number of Partners | 47 |
| Main Assets | 261 hectares of plantation forest in 6 stands |
| Management Committee | C M Mulcock, A C Allison, N C Pilbrow |
| Forest Manager | Warren Forestry Ltd |
| Accountants | Bartram's |
| Bank | ANZ Bank |
| Independent Forestry Consultant | Patrick Milne, NZIF Registered Consultant |
| Supervisor | Covenant Trustee Services Ltd |


**AH1 at Ahuriri Farm, Sept 2019** **Radiata pine aged 22.5**

# SIX HILLS FOREST PARTNERSHIP

## Forest & Joint Venture Particulars + 2019 Annual Report

**Nature of Business**
The sole business activity of the Partnership is to grow and then harvest a plantation forest in six forest stands on land provided pursuant to Joint Venture Agreements ('JVAs') by four landowners in 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 79/21%. 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 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.
**GT7:** 55ha Radiata pine (seed lot GF19 seedlings) planted in 1997; clearwood regime, i.e. high pruned and thinned, to 330 sph (stems per ha). Expected harvest about age 30 (2027), although it may be earlier. Partnership/Landowner shares: 73/27%.
**GT10:** 50ha Douglas-fir (seed lot Fort Bragg) planted in 1996, framing regime i.e. unpruned. The stand is unthinned and averages about 1100 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 2036. However there could be a production thinning at some point if it becomes feasible. Shares are 73/27%.

**Leslie Hills:** 3,440ha sheep & beef farm north of the Waiau River, south of Hanmer Springs, North Canterbury foothills owned by Duncan Rutherford and family.
**LH2:** 43ha Radiata pine (seed lot GF19 seedlings) planted in 1997; an unthinned framing regime. Expected harvest at about age 30 (2027). Shares 79/21%.

**Hopefield Station:** 2,000ha sheep & beef farm northeast of Waiau, North Canterbury foothills owned by M Satterthwaite.
**HF1:** 32ha Radiata pine (seed lot GF19 seedlings) planted in 1997; all clearwood regime, thinned to 500sph. Expected harvest at about age 30 (2027), but quite possibly earlier. Shares 79/21%.

**Ahuriri Farm: 1,400ha** sheep & beef farm on the southern Port Hills, between Tai Tapu & Gebbies Valley, Banks Peninsula owned by P & A Graham and family.
**AH1:** 47ha Radiata pine (seed lot GF19 seedlings) planted in 1997; all clearwood regime, thinned to 330sph. Expected harvest about age 30 (2027) or earlier. Shares 73/27%.
**AH2:** 27ha Radiata pine (seed lot GF17 seedlings) planted in 1996; all clearwood regime, thinned to 330sph. Expected harvest about age 30 (2026) or earlier. Shares 73/27%.

# Annual Report

**General & 2019 Specific Information**

**Forest Growth & Health:** All was well in 2019. The six 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 sum current insured was set in May 2019. 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 acceptable to the insurer so probably could easily be 50% higher or lower, which would of course be reflected in the premium.
We decided to insure above the then current valuation (31 Dec 2018) in case values kept rising up to 30 May 2020. As it happened, that turned out to be close to the 31 Dec 2019 valuation.

| | |
|---|---|
| Actual sum insured (total fire cover) | $5,577,900 |
| Olsen's Insurance value for 2019/20 | $5,517,755 |
| Forest Valuation as at 31/12/18 | $5,205,162 |
| Forest Valuation as at 31/12/19 | $5,602,533 |
| | |
| 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 | $16,420 |

**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 significant windfall and we have received enough cash by selling down our (old) NZUs gradually to cover all outgoings for many years. We still have around $148,000 worth at current value.

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. But mostly those fail.

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, especially of Douglas-fir could 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, especially for our large, longer rotation Douglas-fir stand. 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 | | | |
|---|---|---|---|
| **Operating costs** | **Budget 2019** | **Actual 2019** | **Actual 2018** |
| Accountant's fees | 2,000 | 1,940 | 1,748 |
| Bank charges | - | 63 | 73 |
| ETS associated work | 500 | 500 | 800 |
| Insurance | 14,500 | 16,420 | 13,373 |
| Management & Administration by WFL | 7,900 | 7,900 | 8,249 |
| Supervisor: annual fee | 1,500 | 1,500 | 1,500 |
| Subscriptions | - | - | 115 |
| Track maintenance | 1,500 | 2,140 | 450 |
| | 27,900 | 30,463 | 26,308 |

## 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.

**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 again 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.

**Track Maintenance:** We decided the GT7 track should be graded as it had become almost impassable. The grader was on the farm doing other work at the time.

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

**February 2020**

**PTO for some pics…**

**LH2, Leslie Hills in three shots in Jan 2019. Aged 21.7**