

The secondary market for interests in forests – what can we learn from it?

Bruce Manley¹

Although the market for forests in New Zealand is very thin with a limited number of transactions, there is an active secondary market for the sale and purchase of interests in investment forests. A large number of these forests have been established over the last 30 years, particularly since 1990. Typically, each forest is owned by a syndicate of investors under a company or partnership investment structure.

Each year there are a significant number of transactions as some investors liquidate their investment. These sales are often to other investors in the forest, who may have pre-emptive rights.

Each investment promotion company has developed its own mechanism to facilitate transactions in their secondary market. Some examples are:

Roger Dickie New Zealand Ltd

Roger Dickie New Zealand Ltd was established in 1971 and manages 77 forests with an area of 26,450 ha. These forests are concentrated in the Hawkes Bay and Gisborne regions.

The Company promotes both private investments (by an individual investor or a small consortium) and partnership investments. Partners in the latter own an undivided share of the forest and freehold land.

Relatively few partnership shares are sold on the secondary market. Last year only 8 shares were sold - primarily as a consequence of matrimonial property splits. Fellow partners have a pre-emptive right to purchase shares that are for sale. These rights are generally exercised - in the last 6 years only 2 shares have been sold outside a partnership.

The Company assists sellers by providing an indicative value. This is based on the forest valuation (which is done every 2 years for insurance purposes, currently using a discount rate of 8.3% on after-tax cashflows), the land value, the bank balance of the partnership and the residual value of set-up costs.

Forest Enterprises Ltd

Forest Enterprises was established in 1972 and manages 73 forests with a total area of 21,720 ha. These forests (located in the Wairarapa, Hawkes Bay and Gisborne regions) are owned by over 6000 investors.

Investments established from 1972 to 1992 have a partnership structure. Partnership shares are only rarely traded on the secondary market because other partners normally exercise their pre-emptive rights to purchase any shares for sale.

Since 1992 Forest Enterprises has adopted a company investment structure. Each forest investment is set-up as a limited liability company. Investors wishing to sell their units pay a listing fee to Forest Enterprises who act as a broker in matching sellers with prospective buyers. Forest Enterprises advertise investments for sale through their website and through mailings to their client list. The information provided to prospective buyers includes

an indicative value. The sale and purchase process is by open tender. Negotiations sometimes occur around the tendered price with Forest Enterprises acting as the intermediary. In 2001 there were 34 transactions on the secondary market - in 2000 there were 46 transactions. These figures are for genuine arm's length sales. Forest Enterprises report that there were probably twice this number of related party transfers; i.e. transfers to trusts, beneficiaries on death, and private sales.

Currently (April 2002) there are interests for sale in 15 different forests with indicative values between \$3,800 and \$24,400 per investment unit. These values include the value of land as well as the value of the tree crop.

Greenplan Forestry Ltd

Greenplan offered its first prospectus in 1993 and now has 55 partnerships in which 5000 investors own a total of 6000 ha. All forests are located in the King Country.

Features of Greenplan investments are that

- each investment unit is equivalent to about 1 ha of forest;
- silvicultural costs are prepaid. Investors pay an on-going annual fee of \$60/ha.

The first feature provides for comparability between



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¹ Bruce Manley is Associate Professor in Forest Management at the School of Forestry.

investments while the second means that the sale of units in young forests essentially involves the sale of two assets – the crop and prepayments. Land is owned by an associated company Greenplan Holdings that grants partnerships a 40 year Forestry Right. Consequently, unit-holders in partnerships do not own land.

Investors who wish to sell their units contact Greenplan and set a selling price. Greenplan provide the seller with details of the sales history for similar units and suggest a range in which they might choose a price to sell at. Willingness to sell determines the asking price set by the seller. Greenplan charges the seller a commission of 2%.

Greenplan lists units for sale on their website as well as in their quarterly newsletter. The listing includes details of the partnership, the year of planting and the price. Prices are generally non-negotiable. Consequently units that are set higher than the market will bear do not sell.

Other partners have a pre-emptive right to purchase units in Greenplan partnerships 1 to 40. This pre-emptive right does not apply to later partnerships.

During 2001 around 80 units were sold on the secondary market for a total value of approximately \$700,000. Prices ranged from \$12,500 for 1994 plantings, down to \$7,000 for 2001 plantings.

What can we learn from the secondary market to assist us in forest valuation?

The secondary market has the potential to provide useful information on the market for forests. However at present there are a number of limitations:

Segmented market

Each company has its own secondary market. There are difficulties in making comparisons between each market because the units used differ in terms of

- The stocked area per unit;
- Whether the unit includes land or not;
- Whether the unit value includes prepayment of silvicultural costs.

Managed markets

Each company manages the sale process and provides guidance on the price. Steve Croskery, then Senior Forester with Forest Enterprises suggested (Croskery 2000) that "Most prospective buyers on the secondary market wouldn't have a clue as to what would be an appropriate price other than the values we provide. Is the valuation a good reflection of the sale price or does it in fact drive it by way of

providing otherwise unavailable information and guidance?" Nevertheless, the fact that transactions take place indicates that the buyers are willing.

Willing sellers?

Croskery (2000) also noted that the turnover in the secondary market was very low – 'the equivalent of an annual turnover of one third of one per cent of all the investment units. Furthermore, most of these sales arise as a result of matrimonial splits, deaths, people leaving the country, redundancy and inability to meet further contributions, and in these situations the vendor or their agent is often under some pressure or compulsion to sell quickly. Offers are often opportunistic and this transaction environment hardly meets that associated with 'market value'.

These imperfections notwithstanding, what can we learn from the secondary market?

Fig. 1 shows the asking price for units on offer (at 1 April 2002) on the Greenplan secondary market. There is a strong trend with age. It would be useful if similar information on the actual selling price was publicly available. However to make the market price of the crop

Fig. 1: Secondary market units for sale from Greenplan Forestry Ltd (as at April 1 2002).

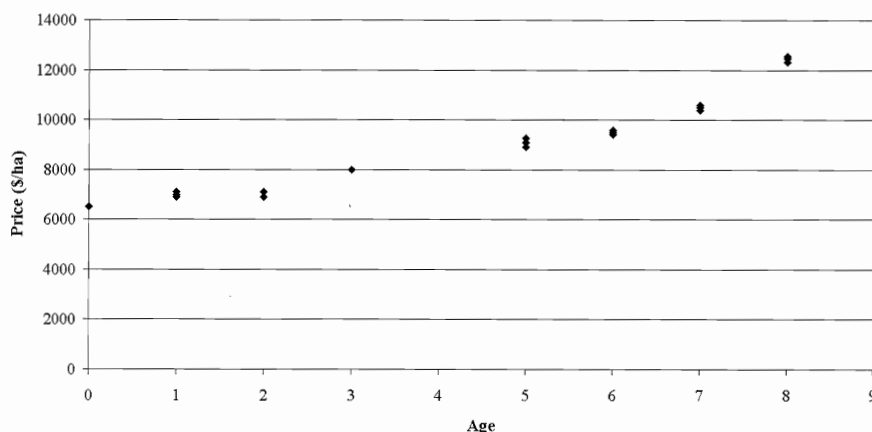
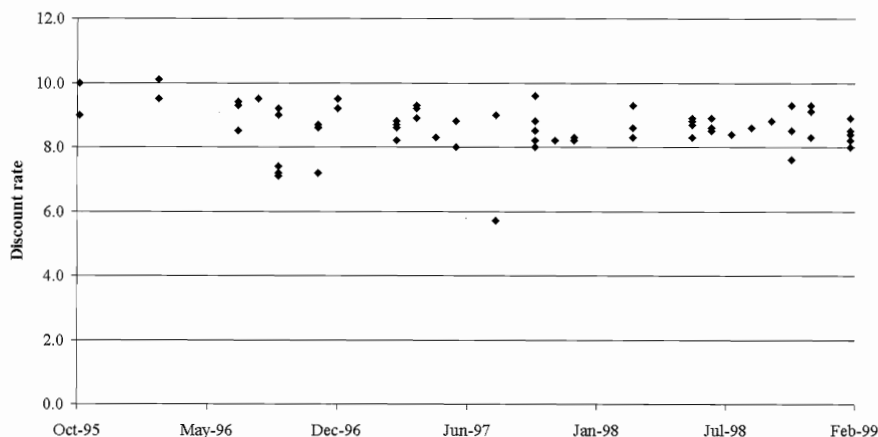


Fig. 2: Implicit discount rates (after-tax cashflows) in transactions on Forest Enterprises Ltd secondary market (Source: Croskery (2000)).



evident it would be necessary to strip out the value of the prepayment of silvicultural costs from the unit value.

The Greenplan asking prices shown include varying amounts of prepayments – the age 0 units relate to 2002 planting and will be all prepayment, the units for older stands include the cost of remaining silviculture.

While a graph of \$/ha on age might be instructive, transaction information would be more comparable if it was presented in terms of the implicit discount rate in each transaction. Such an approach would be more generic because \$/ha is not only influenced by age but also by such factors as location, productivity and terrain.

Fig. 2 shows the implicit discount rates for transactions on the Forest Enterprises secondary market from November 1995 to February 1999 as presented by Croskery (2000). They are the discount rate that equates the sum of discounted after-tax cashflows to the actual transaction price for each unit. They were calculated using standard assumptions including average MAF log

prices for the previous 12 quarters.

Were all transactions on the secondary market publicly reported in a similar way, a rich source of information on discount rates in the market for shares or units in investment forests would be created. This information would complement that available from the limited number of forest sales that are reported.

Reference

Croskery, S. 2000: Forest valuation – a practitioner's experience. In Proceedings of Pan Pacific Congress 2000: Appraisers, Valuers and Counselors.

Source Material

Material for this article was obtained from the websites of the various promoters and from follow-up communication with Richard Bourne of Roger Dickie New Zealand Ltd, Steve Wilton of Forest Enterprises Ltd and Bruce Maunsell of Greenplan Forestry Ltd.

Land and crop interface

Mike Marren¹

Introduction

The preferred method used by land valuers to estimate land value and foresters to estimate crop value is by reference to comparable market evidence. However, when this is not available the valuer of either profession has to determine the value estimate by other methods.

When applying other methods the interface between crop and land value must be considered and it is important to unbundle the forest-operating business from the land-owning business. There has been much confusion from valuers of both land and the crop over recent years by failing to differentiate between these two entities. If the valuer at the outset draws a line between the land-owning entity and the forest-operating business, the valuation exercise becomes much more definable.

Foresters have increasingly adopted the Net Present Value (NPV) methodology and the NZ institute of Forestry (1999) has attempted to clarify the application of this method of crop valuation. This method values the cashflows of the forest (land and crop) expected by the forester. The value of the crop is then determined by deducting an estimate of the land value from the forest value.

The estimate of land market value (LMV - which is defined as the sum of the land value and the value of improvements applicable to the use of the land) is an issue for the crop valuation as a number of approaches can be used. Again the NZIF Forest Valuation Standards make consideration of the matter in that the preference is for the crop valuer to calculate the land expectation value (LEV). If the land can be purchased at the LEV price and all the assumptions in constructing the LEV and forest cash flows are met then the project will return the required investment rate.



¹ Mike Marren is Managing Director of RM Consulting Ltd. He is a Registered Forestry Consultant.

When land market value (LMV) is less than the LEV then there is an advantage to the forest project and can be regarded as either an increase in the rate of return on the investment or a forestry land use differential. However when the LEV is less than the LMV and the project proceeds, then either a lower rate of return is implicit or there is some external financial input to top up the cash flows so that the crop value is maintained.

In any case the crop valuer needs to know the LMV when valuing a forest. The crop valuer also needs to be aware that the methodology used by the land valuer may impact on them.

Recent land valuation tribunal decisions

There have been two recent land valuation tribunal decisions where the subject land was in forest. In assessing the LMV, land had to be valued using available evidence for agricultural land with adjustment for the forestry use.

Tahorakuri

In this instance the issues related to what adjustments were appropriate to apply to pastoral sales evidence to estimate land value under forest. The subject property had a long history of forest use whereas the market evidence was from developed high production farmland.

The debate was between Fletcher Challenge Forests Ltd (the forest owner) and the Valuer General in relation to Rating Roll valuations. The Land Valuation Tribunal (LVT) decision was appealed to the High Court, their decision appealed to the Court of Appeal and its decision was referred back to the High Court for their reconsideration.

The legislation under which this valuation was undertaken required the Valuer General to determine the value of land and trees and deduct the tree value to determine the land value for the Rating Roll. In practice the tree value was ignored and only land value determined (land value as defined under the Valuation of Land Act