Institute of Foresters of Australia & Australian Forest Growers (IFA/AFG)

Submission to the Department of Agriculture Consultation on Plantation Development Concessional Loans

IFA/AFG Forest Managers and Growers inputs and replies to discussion question

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Discussion questions

1) ***How should plantation development concessional loans be best structured to support the expansion of Australia's plantation estate?***

The five forestry hubs that have been initiated under the National Forest Industries Plan seed funding arrangements are now active with four more planned to commence activity in 2020. In reports to AFPA meetings it is clear that all five of the currently formed hubs have commenced quite detailed market and industry capacity analysis exercises that will identify where growth is needed for the long-term growth of the hub partners and the forest industry overall in their regions.

These planning exercises will identify where projected market shortfalls in wood supply exist and their scale. These shortfalls will be in specific plantation species types (exotic pine, eucalypt pulp wood, eucalypt sawlog etc) and require qualities of tree (genetics, form, size, pruned/unpruned) to be grown to achieve processing efficiencies for identified or target markets. The concessional loans scheme should support these plans to grow the wood supply market for specific markets and processing options if grower confidence to invest in plantations is to be achieved.

In the prevailing low interest rate commercial environment, the cost of money is currently not the limiting factor in business cases for plantation expansion projects as may have been the case over much of the last decade. Consequently, large Timber Investment Management Organisations (TIMOs) and other large corporate investors are less likely to apply for a large percentage of the available funds that the government has committed to this concessional loan scheme. Therefore small private plantation grower investors and farm forestry projects are more likely to require the assistance of these concessional loans to invest in plantings on the scale suggested in the National Forest Industry Plan (approximately 100,000 ha of the 400,000ha plantation expansion required to achieve the 1 Billion Trees planting goal).

It is likely that there will be a limit to the amount of large company investment for new plantings and it is unlikely that public investment (state or local government) will be large in most hub regions. Therefore, the hub management teams are likely to identify a shortfall in plantings to achieve their proposed supply needs and these plantation expansion targets provide a prime opportunity to small private growers to invest in sought after and needed plantation investment.

To engender enthusiasm in small growers and farmers a legacy of trust issues needs to be addressed. These have been highlighted in the outcomes of the FWPA – Industry "Next Generation Plantation Investment" project and are captured in this report …

https://cpb-ap-se2.wpmucdn.com/blogs.unimelb.edu.au/dist/d/279/files/2017/10/Research-report_What-do-landholders-think-1mmcnbc.pdf

Survey findings included:

> "Survey respondents had quite different views about planting trees for

commercial harvest (see Figure 1). Views about the on-farm benefits of trees were relatively evenly spread amongst survey respondents, with 37% of respondents agreeing and 37% disagreeing with the view that trees planted for commercial harvest could provide on-farm benefits. Views that trees for commercial harvest conflicted with the main farming business were also divided, with over one third of survey respondents (44%) agreeing with this view, while slightly fewer respondents (39%) disagreed with this view. There was more consensus about the importance of financial returns from commercial plantings, with only 23% of respondent disagreeing with this view."

And

"Models for establishing trees for commercial harvest on rural land can vary. Responsibility for establishing and managing the trees and associated costs and the distribution of financial returns can differ between different landowners. The following models were identified from survey responses:

1. Independent grower
   The landowner is responsible for establishing and managing the trees, including stump removal, if needed, at the end of tree rotation. The landholder retains ownership of the trees until they are sold. The landholder pays all costs associated with establishment and management of the trees and receives all or a share of the net proceeds at the prevailing market price at the time the trees are sold. The landowner bears the costs, risks and potential returns.
2. Commercial partnership
   The landowner provides the land and a commercial partner is responsible, and pays all associated costs, for establishing and managing the trees, including stump removal. The partner retains ownership of the trees. The landowner receives either an annual payment or a share of the net sales proceeds. Also acceptable within this model were an 'offtake agreement' with an agreed price determined before the trees are planted, or an annuity tied to the projected returns from timber sale. The commercial partner bears the costs and most of the risk.
3. Shared ownership
   The landowner provides the land, a commercial partner is responsible for some aspects of establishing and managing the trees, with the landowner also contributing some work (e.g. fencing or weed control). Ownership of the trees is shared proportionally by prior agreement according to the value of inputs. The landowner may be paid for the work done and receives an annual lease payment with no share of the sales proceeds. Alternatively, the landowner may contribute an agreed share of the costs (in cash or in kind) and receive agreed share of the net sales proceeds. Costs and risks are shared in this arrangement.

All three models were acceptable to respondents in the survey, although model preference varied. The shared ownership model tended to be favoured by most respondents."

The planning work of the hubs should support and underpin the development of a "Shared Ownership" model supported by clearly articulated, simple English contracts that specifies agreed costs and risks as well as the inputs impacting on the agreed % returns to the grower.

The consultation paper suggests that establishment be targeted at 40,000 ha per year for 10 years. IFA/AFG supports this level and believes the process should include mechanisms to smooth out peaks and avoid troughs. We recommend that the hubs should be consulted to indicate their 10-year target plantation expansion goals and the 40,000 ha p.a. target be pro-rata allocated to hubs so that firstly they are encouraged to reach their goals but also to account for the variation in goals for new plantation areas that will almost certainly occur amongst the hubs.

By limiting concessional loan support to an annual target, with some flexibility to account for drought years and other temporary resourcing issues, it would be hoped that past mistakes would be avoided as highlighted in the Consultation Paper …

> Establishing 40,000 hectares of plantations a year is less likely to have distortionary impacts on land prices, when spread across the country, than attempts to establish significantly larger areas in fewer years.
>
> At the peak of the MIS plantation expansion, 110,000 hectares of plantations were established in a single year (2000). Plantation expansion at this rate resulted in higher prices than expected for some land holdings and some plantations being established in the wrong areas.

Loans would be through the Regional Investment Corporation, an existing stable entity which IFA/AFG supports, although they will need to access forestry skills that may not be currently accessible. IFA/AFG will be available to consult and suggest options to the Department to address this latter point.

The Consultation Paper also states:

> " To identify the viability of any plantation development the use of suitably qualified professionals is vital to ensure that the economic viability of any plantation establishment has been considered adequately. This is also a fundamental consideration of any support from the Australian Government".

The IFA/AFG Registered Forestry Professional (RFP) scheme is well placed to assist the delivery of detailed and robust plantation development plans. Details of how RFPs can be utilised will be addressed separately in this submission.

2) Are there other mechanisms the Australian, state or territory governments could use to support plantation expansion more effectively?

Current Australian government funding arrangements with State and Local governments should be utilised to support key infrastructure upgrades or investments. The hubs will identify priority projects needed to deliver their expansion of the forest industry and this may include port and rail facilities as well as bridge (load limits) and roading upgrades – with 10 year planning horizons the Australian government should partner with State and Local governments to provide prioritised funding support for key infrastructure projects in the budget forward estimates. The ability to stagger investments as needed with time over a 10-year period should assist budgeting at all levels of government.

It is recommended that investment outside the hubs also be considered as some projects (e.g. export wharf facilities at Kangaroo Island) would encourage plantation establishment investment to cost-effectively feed otherwise stranded resources into hub supply chains. In the last3-4 years, the establishment of the rail log handling and transport facilities in Goulburn NSW has changed the economics of farmer and small grower plantation harvest returns in the Monaro region that previously provided marginal returns with long haul distances to Tumut/Tumbarumba. Hubs should be encouraged to consider opportunities to invest in key targeted infrastructure projects outside their boundaries that would open up additional wood supply options to address their fibre supply needs; and then recommend these for government support and/or co-investment.

What finance terms on concessional loans would influence you to actively expand your plantations?

Farmers and small growers face considerable debt burdens to develop and restore older farming properties to viable and resilient enterprises.

The Consultation Paper indicates:

> A concessional loan is a loan that has more favourable terms and conditions than those offered by the commercial finance market. The most common favourable term is a lower interest rate. Favourable terms may also include a longer loan term, or deferred or waived interest payments for a period.

Farmers and small growers are more likely to co-invest in establishing new plantations if favourable terms are offered for concessional loans including loan periods and deferred or waived interest payments in recognition of the long time period from planting to any potential return from a first commercial harvest.

Also recognised in the Consultation Paper is:

> There are significant costs associated with plantation development and the costs are borne by the investor for more than a decade before plantations create income streams.
>
> For softwood plantations, there is the potential for income to be derived around the 15-year mark in areas where there are markets for forest thinnings. Otherwise, the first income can come as late as harvest. Depending on the species selected, and the climatic conditions, harvest can be between 25 and 35 years after planting for softwood logs and between 12 and 15 years after planting for hardwood fibre crops.
>
> Therefore, any loan framework or repayment options developed as part of a concessional loan arrangement will need to take account of the ability of the proponent to make interest payments and the timing of the repayment of the principal.

It is important for the success of plantation projects that processing markets for plantation thinnings are developed and available to provide earlier returns on investments. These could be bioenergy plants, rotary peeling machines or export facilities. Without these farmers and small growers will have long investment horizons to re-coup returns and will question their value versus annual cropping or livestock management returns that mostly provide annual returns from year 1.

The above passage also does not mention hardwood sawlog plantations that require long rotations (40-50 years) to produce high quality and value timber. With the majority of Australia's native forest hardwood forest resource being withdrawn from harvest or being highly restricted by state government legislation alternative plantation timber resources are needed to meet future needs for high quality hardwood timber grown under sustainable forest management practices.

What limitations on loan eligibility should apply to loan applicants, to ensure that the right trees are planted in the right place at the right scale?

To avoid the criticisms and address trust issues arising from the collapse of MIS companies a decade ago plantation proposals should be developed in consultation with an IFA/AFG Registered Forestry Professional (RFP) or at the very least signed off on against a range of appropriate economic, environmental and regulatory criteria. IFA/AFG agrees that it should be mandated to include professional oversight in the process to qualify for loan eligibility.

Do you have any other comments on loan eligibility or loan terms?

Loan eligibility should be based on a co-investment model to encourage all new plantings to be valued by the owners as important economic additions to the farm or private forest grower enterprise. IFA/AFG suggests investors should provide 20-25% of the investment needed for the project with a cap on the concessional loan proportion for the total project. Past funding grant models where no owner financial risk was involved resulted in poorly managed or maintained plantings and failed or stranded resources.

Farmers and private growers need to be convinced that the economics for investment are sound and returns will justify their 'buy-in'.

Loan terms need to reflect the rotation length required for targeted products with flexibility for more favourable terms for longer rotation crops.

Are there red tape issues that are constraining plantation expansion?

Audit costs to engage in carbon markets are prohibitive for farmers and small forest growers.

Independent audit costs of $8,000 to $10,000 for 5-yearly audits are prohibitively expensive for small growers.

Are there localised planning issues that are limiting plantation expansion?

For farmers and small forest owners the lack of transparent information on local markets and log pricing needs to be addressed. Local hub members will need to provide this information in a business proposition to potential new plantation growers to engender confidence for investment.

Additionally, hubs should undertake some analysis of the economic viability of plantings in their region to establish minimum area restrictions as part of their business case to attract grower investment. Comparison of returns for 10, 25, 50 and 100 ha block plantings would be useful to identify what is an economically viable planting. The latter will also need to specify key caveats including haul distance to mill and roading access/harvest costs (e.g. if existing farm access is poor and the planting is established on steep slopes far from the main gazetted road harvesting costs including access roading may make any small planting <50ha non-commercial).

Also, what is the harvesting capacity within the hub region – one reason that farm forestry succeeds in New Zealand is that small scale harvesting contractors are available. The latter have customised their plant and equipment to reduce costs to harvest small blocks (10 ha and less) and they are available for farmers and small investors whereas large corporate harvesting contractors generally have very large operating overheads that make them unaffordable for small growers even if they are not fully committed to large corporate clients. The hubs should be encouraged to communicate with local forest contractors to encourage them to develop 'small grower friendly' harvesting crews and equipment that are suited to working small blocks at reasonable costs. It is likely for most hubs that there will be considerable lead time before enough small grower resource is available within a defined haulage area to justify the investment in this specialised harvesting plant and equipment.

What do you believe are the main factors that limit plantation expansion in Australia?

Investment by farmers and small private growers is limited by cash availability, financial ability to wait for returns until harvest age/s while incurring maintenance costs, opportunity cost Versus alternative land use (cropping, livestock, horticulture) and trust in the forest industry given widely reported or experienced negative history form the collapse of MIS companies a decade ago. Currently there may also be a level of concern about long term forest crops and their resilience to climate change impacts on weather patterns.

What other mechanisms by government could support plantation expansion?

Registered Forestry Professionals should be authorised under a government regulated system (government could outsource to the IFA/AFG) under the following terms:

- RFPs must hold appropriate tertiary qualification in forestry or a related discipline with expertise in or at least access to the following skills:
  - species selection,
  - soil science,
  - basic hydrology,
  - agronomic skills associated with weed control,
  - pest and disease management,
  - fire risk management,
  - plantation silviculture
  - forest economics
  - forest planning
  - plantation harvesting systems
- RFPs, with appropriate training and accreditation, be authorised to draw up plantation management plans;
- An RFP with delegated authority makes a decision to certify, refuse to certify or amend an application for a certified plantation management plan (with appropriate appeal rights);
- RFPs are authorised to undertake inspections to ensure the plantation management plan is being implemented (this could be a random annual sample funded by the Department to provide appropriate oversight independent from the Concessional Loan provider).

Do you have any other comments on loan eligibility or loan terms?

Loan eligibility should be based on a co-investment model to encourage all new plantings to be valued by the owners as important economic additions to the farm or private forest grower enterprise. IFA/AFG suggests investors should provide 20-25% of the investment needed for the project with a cap on the concessional loan proportion for the total project. Past funding grant models where no owner financial risk was involved resulted in poorly managed or maintained plantings and failed or stranded resources.

Farmers and private growers need to be convinced that the economics for investment are sound and returns will justify their 'buy-in'.

Loan terms need to reflect the rotation length required for targeted products with flexibility for more favourable terms for longer rotation crops.

Are there red tape issues that are constraining plantation expansion?

Audit costs to engage in carbon markets are prohibitive for farmers and small forest growers.

Independent audit costs of $8,000 to $10,000 for 5-yearly audits are prohibitively expensive for small growers.

The right to harvest needs to be recognised at all levels of government. It is reasonable to limit (not prohibit) harvesting in riparian zones to protect riparian values, which may have been enhanced by plantation establishment. Land-owners should be funded by concessional loans to restore riparian values along streams and be given rights to remove trees with retention limits. Plantations outside riparian zones should be treated like any other agricultural or horticultural crop as far as possible. The rules in place at time of establishment should be applied throughout the entire rotation and not be subject to significant change until the trees are finally removed.

At the post-harvest point there is a real problem of lumpiness of returns. It is possible to utilise the Farm deposit scheme but there are significant problems with the conditions attached to it for forestry. There is a requirement that there is a continuation of primary production; the amount one can place and the time it has to be used up. Each of these conditions are not suitable for forestry.

It would be helpful if the Forestry deposit scheme was available without the requirement to continue as a primary producer. By the time a grower has funds from a 30+ years rotation it is often the case that retirement is imminent and the grower wishes to exit the industry. It has taken a long time to realise the money and the length of time should be extended to say 10 years to even out the taxable income more realistically. The amount one can place is not large enough for a one-off return and this could be increased.

Are there localised planning issues that are limiting plantation expansion?

For farmers and small forest owners the lack of transparent information on local markets and log pricing needs to be addressed. Local hub members will need to provide this information in a business proposition to potential new plantation growers to engender confidence for investment.

Additionally, hubs should undertake some analysis of the economic viability of plantings in their region to establish minimum area restrictions as part of their business case to attract grower investment. Comparison of returns for 10, 25, 50 and 100 ha block plantings would be useful to identify what is an economically viable planting. The latter will also need to specify key caveats including haul distance to mill and roading access/harvest costs (e.g. if existing farm access is poor and the planting is established on steep slopes far from the main gazetted road harvesting costs including access roading may make any small planting <50ha non-commercial).

Also, what is the harvesting capacity within the hub region – one reason that farm forestry succeeds in New Zealand is that small scale harvesting contractors are available. The latter have customised their plant and equipment to reduce costs to harvest small blocks (10 ha and less) and they are available for farmers and small investors whereas large corporate harvesting contractors generally have very large operating overheads that make them unaffordable for small growers even if they are not fully committed to large corporate clients. The hubs should be encouraged to communicate with local forest contractors to encourage them to develop 'small grower friendly' harvesting crews and equipment that are suited to working small blocks at reasonable costs. It is likely for most hubs that there will be considerable lead time before enough small grower resource is available within a defined haulage area to justify the investment in this specialised harvesting plant and equipment.

Unfair focus on tree plantations compared with other agricultural crops has been a major disincentive. For example, the requirement for tree plantation establishment in South Australia to account for water usage, when other intensive agriculture crops are not required to do so. Local Councils can also use Council By-Laws to restrict use of roads and bridges, change zoning and use other mechanisms to frustrate the establishment, management and harvest of plantations and this has been experienced by some of our members.

What do you believe are the main factors that limit plantation expansion in Australia?

Investment by farmers and small private growers is limited by cash availability, financial ability to wait for returns until harvest age/s while incurring maintenance costs, opportunity cost versus alternative land use (cropping, livestock, horticulture) and trust in the forest industry given widely reported or experienced negative history form the collapse of MIS companies a decade ago. Currently there may also be a level of concern about long term forest crops and their resilience to climate change impacts on weather patterns.

The Carbon Farming Initiative (CFI) is too restrictive and only supports a small part of the potential plantation sector. The CFI should support plantation projects that provide carbon sequestration and storage benefits throughout the value chain. Substitution of fossil fuels with bioenergy should also be recognised in the CFI and plantations can play a key role.

Other identifiable risks:

- Risk from damage from drought, hail wind storms, pests, diseases and fire are major concerns.
    - These risks often increase with lack of silviculture such as thinning and removal of residues;
- Concerns about land being tied up for decades across generations and/or ownership of properties;
- Sovereign risk associated with changes in State and local government planning schemes (changing rules about right to harvest, use of local government roads etc.);
- Insurance costs
    - insurance could be underwritten by government for properties that have appropriate risk mitigation practices, especially where natural disasters such as fire and extreme weather impact on plantations;
- Certification costs
    - voluntary certification schemes can be prohibitively expensive and there is no premium price for certified wood.
    - Uncertified wood is difficult to sell – it could be argued this is a restrictive trade practice and should be reviewed in the light of adequate government regulation of sustainable forestry.
- Distortion of property prices when large companies enter the property market to secure property for large plantation estates.
- Social risk
    - plantation developments take more than a decade to reach maturity. In that time there are social concerns about change in land-use, perception of lack of employment and collapse of rural infrastructure and economies. Plantations are often the symptom rather than the cause, but the perception is real and needs to be dealt with;
- The collapse of MIS schemes has left a significant scar on small-scale investors, land-owners and small businesses who relied on the forestry expansion;
- Mechanisms to avoid:
    - greed, over-exploitation of incentive schemes:
    - over-commitment: and
    - under delivery

  will be needed:
- The long-term nature of forest plantations requires robust legal, financial and management arrangements to ensure appropriate silviculture is undertaken to produce products suitable for market;
- The need to achieve economies of scale versus small scale land-owner desire to have a boutique plantation project needs to be understood;
- Plantation effects on local hydrology needs to be well understood. The baseline should be the original pre-European vegetation hydrology or dryland extensive agriculture, not the intensive irrigated horticulture.

Questions for the Australian Government

- Why do large overseas investment funds such as USA and Canada based superannuation funds see plantation investment in Australia as secure whereas there is very little to no interest from large Australian private and sovereign funds?
- Are there tax and investment rules which discourage investment by Australian entities?

What other mechanisms by government could support plantation expansion?

Security to be able to establish manage and harvest trees. The Tasmanian Private Timber Reserves under the *Forest Practices Act 1985* is a good example of giving long term security to plantation and private native forest owners.

A relatively simple regulatory process that ensures sustainable forest management. This could be backed up by a Forest Plantations Practices Code with an emphasis on planning before operations. The Code would cover harvesting and reforestation practices including protection of soil and water, maintenance of productivity, landscape level planning including visual impacts, biodiversity and cultural heritage. The Tasmanian forest practices system offers a good model even though it started as a system for native forest management.

Concessional loans to fund mid-rotation silvicultural operations including weed control and hazardous vegetation removal (fire mitigation), maintenance of fire-breaks, thinning (often these are only break-even or slight loss-making operations even where there are good markets), pruning (where market premium for clear knot-free wood can be demonstrated).

Forestry rights so that ownership of the tree crop can be separated from the land title with appropriate mechanisms to allow land and tree owners certain rights to access land and trees respectively should the other party face legal or financial stressors.