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Report to the Policy and Finance Committee
from Barry Leonard, Manager, Plantation Forestry

Forest Exit Strategy : Scoping Study

1. Purpose

To advise the Committee of the results of the Scoping Study undertaken as part of the Forest Exit Strategy.

2. Exclusion of the Public

Grounds for exclusion of the public under section 48(1) of the Local Government Official Information Act 1987 are:

> *That the public conduct of the whole or relevant part of the proceedings of the meeting would be likely to result in the disclosure of information for which good reason for withholding would exist, i.e. to carry on commercial negotiations.*

3. Background

A proposed Forest Exit Strategy was reported to the Policy and Finance Committee on 8 April 1999 (Report PE 99.96). Amongst other things, the Committee resolved to:

(8) ***Agree*** *that:*

(i) *Officers proceed with the sale scoping process for possible sale of forestry cutting rights; and*

(ii) *Any decision on the sale of forestry cutting rights be considered within the Long-term Financial Strategy review.*

4. Sale Scoping Process

PricewaterhouseCoopers (PWC) were engaged to carry out the scoping study (**Attachment 1**).

PricewaterhouseCoopers approached all main participants in the forestry industry and asked each of the parties their views on a number of factors.

The views of these parties can be summarised in the following sections.

4.1 Price Expectations in the Near Future

Positive	Four Parties
Flat	Seven Parties
Negative	Nil

4.2 Volume Expectations in the Near Future

Positive	Eight Parties
Flat	Zero
Negative	Zero

4.3 Discount Rates on a Possible Sale

1 party	@	8.5%
2 parties	@	>9%
2 parties	@	9.5-10 %
2 parties	@	10-10.5%
2 parties	@	10.5 % plus

Council has traditionally used 8% discount for its valuations with 9% as a sensitivity factor.

4.4 The Extent of Interest in a Purchase at this Time or in the Near Future

PricewaterhouseCoopers assessed the following factors as relevant to the likely purchase price.

Positives

- The Groome Poyry valuation related to only one rotation while Council could sell cutting rights for multiple rotations. Although the additional value is low in cashflow terms, the additional rotations could be significant to potential purchasers.

- Generally the forest is well tended and the proportion of higher value pruned logs increases over time.

- The forests are close to Centreport

Negatives

- The forests are too small for a major investor and would need to be combined with other stands or the discount rate increased to compensate.

- The recreational/social requirements may reduce the value through perceived compromises at harvest time due to conflicts. However, Landcare have indicated that there are no real impediments.

- Concerns over the "Wall of wood" as New Zealand's production increase significantly over the next decade.

- The reliance on one market, Asia to absorb the increased production.

Those organisations expressing interest in a possible purchase were firstly provided with a one page flyer giving basic data on Council's stands and if further interest was shown, a more detailed fact sheet was provided.

Potential Purchasers

At the end of the process, PWC assessed that there were only two interested parties, one of whom wished Wellington Regional Council to purchase shares in the venture, and four or five possibilities. PricewaterhouseCoopers stressed that in order to maximise the price paid, an overtly contestable process would be required. It was their view that this would not occur at this time.

5. Discussion

The conclusion from PWC that potential purchasers are likely to adopt a discount rate in the vicinity of 10% effectively reduces the value of the forest at time of sale by about $7 million to around $20 million. Assuming this price was achieved the likely effect on the rate line would be minimal or even negative as detailed in the table below. In the event of a sale, however, debt would be eliminated and increasing future debt no longer an issue. In other words, risk would be eliminated.

Rate Line Impact of Sale

	Sale Price	Less Current Debt	Net Proceeds	Savings Per Annum	%Reduction in Rates
	$M	$M	$M	$	
Assume sale price of	28	13	15	575,000	1.4%
	24	13	11	255,000	0.6%
	20	13	7	-65,000	

Assumptions:

- proceeds used to pay off debt
- current weighted average cost of debt 8%
- $375,000 dividend already provided to rate line
- unrecovered overhead $100,000
- additional costs to Landcare $150,000
- excludes any costs associated with preparing for sale and sale commission.

6. Projected Future Debt Levels if Forests Retained

Should Council elect to retain the forests meantime and continue the current divided policy, projected debt levels are expected to increase to $28.7 million in 2013/14 although the debt /value ratio peaks in 2008/09 at 69.1%. All debt is projected to be repaid in 2028/29. Without dividends, debt peaks at $22.7 million in 2013/14 with a peak debt/value ratio of 61% in 2005/06. All debt is projected to be repaid by 2024/25 (**Attachment 2**).

7. Conclusion

The forestry industry is now well aware of the Council's policy position on the sale of its forests. However, a sale of forest rights at this time would be likely to result in a lack of competitive bids due to the low level of interest. The expected net benefits to the rate line from a sale at this time are likely to be around zero. As the forests mature the market value in net present value terms increases faster than the accumulated debt, with a greater margin between debt and potential sale price (**Attachment 3**). Although debt levels are anticipated to increase to between 61% and 69% of forest value, officers are confident that this level of debt can be managed within the overall Council debt profile.

Should a decision be made to retain the forests it would be prudent to revisit the options of corporatising the activity either as a LATE or as a wholly owned subsidiary as there may be taxation benefits which can be applied to other business units.

8. Recommendations

That the Policy and Finance Committee:

(1) *Notes the Scoping Study reveals little market interest in the purchase of forestry cutting rights at this time.*

(2) *Notes the sale of forestry cutting rights at the present assessed value would provide little net return to Council but would reduce risk.*

(3) *Notes although debt levels are expected to increase to between 61% and 69% of the forest value this can be managed within the Council's total debt.*

(4) *Agrees the forests be retained in the meantime, and this decision be formally reviewed in three years time.*

(5) *Agrees the present dividend policy be maintained and that the dividend and the market situation be reviewed annually during the Annual Planning process.*

(6) *Agrees the present policy of being a seller of cutting rights at the right price and not a holder at all costs be confirmed.*

(7) *Agrees the advantages and disadvantages of transferring these activities to a Council subsidiary be reviewed.*

Report Prepared by:	Approved for Submission by:
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Attachments:
1 PWC's Scoping Study Report
2 Debt Profile Graph
3 Debt Profile and Market Value Graph