



March 10, 2011

Standing Committee on Agriculture, Resources, Fisheries and Forestry
House of Representatives
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Parliament House
Canberra ACT 2600
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Dear Committee Members

Re: Submission to Inquiry into the Australian Forestry Industry

Thank you for the opportunity to make a submission to the Inquiry into the Australian Forestry Industry. I am writing to put forward a submission primarily on the term of reference to create a better business environment for forest industries. Specifically, I will address the benefits of and new ideas for encouraging further institutional investment in the Australian plantation forestry sector.

New Forests Pty Limited is a Sydney-based investment management business managing commingled funds on behalf of Australian and international institutional investors in forestry. We currently manage over \$1 billion in forestry and forestland assets in Australia, New Zealand, Asia and the United States. In 2010 we closed a \$500 million Australia New Zealand Forest Fund, and in late January of this year we completed the acquisition of the 260,000 hectare land bank of Great Southern Plantations from the Receiver, McGrathNicol, along with our client, the Alberta Investment Management Corporation.

Benefits of Forestry in an Institutional Investment Portfolio

New Forests is the only Australian-based institutional investment business dedicated to forestry, and we have grown steadily since our inception in 2005. We believe that institutional investors—superannuation funds, pension funds, endowments, foundations and insurance companies—are the natural long-term owners of forestry assets. Long-term analysis of forestry investments indicates a generally low correlation with other asset classes, such as listed equities and corporate bonds; a positive correlation to inflation; and relatively low volatility in overall returns. These attractive characteristics have led to steady growth in investment over the past 20 years, and recent reports estimate that there is now approximately \$50 billion of institutional investment in forestry worldwide. While 75% to 80% of that investment is in forestry assets located in the United States, the focus of most recent investor interest is the more productive timber plantation assets in the southern hemisphere, including Latin America, New Zealand and Australia. Australia is particularly attractive to investors because of our stable democracy, strong economy, access to skilled labour and infrastructure and exposure to burgeoning Asian timber markets.

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Institutional Investment in Australian Forestry

Until recently, however, it has been difficult to find attractive forestry investments in Australia. The industry has been dominated by State Government owned forestry businesses, on the one hand, and Managed Investment Scheme (MIS) operations on the other. Institutional forestry investment in Australia was successfully pioneered in the sale of the Victorian Plantations Corporation in 1998 and has been followed by partial sales of the Forestry Tasmania timber plantations and most recently the Queensland timber plantations. The recent systemic failure of the MIS industry has provided further opportunities for institutional investors to enter the Australian forestry market. To date there has been approximately \$2 billion of institutional investment in Australian forestry assets. If the remaining state owned timber plantations and MIS assets are rationalized and sold to institutional investors, we expect this will represent an asset base of \$8 to \$9 billion dollars in total value.

Institutional ownership of forestry assets should generally be a positive development for Australia, but it will represent a change to a stronger focus on commercial returns from the management of the forests. MIS companies were often driven by financial product sales and occasionally became undisciplined in the acquisition of land for forestry. In some cases this land will not be viable for long-term forestry production. State Governments have struggled to find the capital to continue expansion of their forestry businesses, as higher priority public services, such as education and health care, place ever greater demands on limited budgets. Institutional owners have continuous access to capital and will invest to meet attractive opportunities in timber markets. Because of requirements from their stakeholders, these investors will also require adherence to high standards of social and environmental performance and will be sensitive to community concerns about land use change and bushfire risk management, as well as the sensible management of increasing industrial operations in coming years. Finally, pension funds, endowments and insurance companies have multi-decade liabilities to manage, and forestry assets are one of the few opportunities to match these liabilities.

Attracting Investment to Australia

In our submission we wish to note the positive factors already in place that make Australia an attractive destination for institutional forestry investors. The recent legislation passed to establish the Managed Investment Trust arrangements has allowed international institutional investors to gain access to concessional tax treatment on passive income. This has been a significant benefit to us as an institutional investment management business, as it allows us to compete against other regions of the world for investment funds. We also compliment the government on the operations of the Foreign Investment Review Board, which has been more efficient and effective than the review processes of many other countries where forestry investment is expanding.

Australia has some broader impediments to forestry investment that the Committee may not be able to address in the short term but which we will raise in any event for completeness. The first is the high rate of stamp duty on the transfer of rural property. This is a significant drag on investment liquidity, and the variety of State Government rules adds complexity to transactions. It is a disincentive to investors in Australia, vis-à-vis New Zealand, for example, where no stamp duty is charged.

We would also note that the dominant market position of State Governments in some timber markets, can be a disincentive to private investment in timber plantations. Governments have fulfilled an important role in building the tremendous legacy of softwood plantations in Australia and doing the early research work on blue gum plantations that supported the scaling up of this industry. It is now time for governments to exit from plantation timber markets. This is a globally competitive area of investment, and the continuing presence of government as a major commercial player in Australia is no longer necessary.

Government should continue to play a role in supporting the plantation forestry industry, as it does with all industry sectors. This would include public research, facilitating industry research and research cooperatives and supporting the diffusion of new technologies. Education also is critical to the competitiveness of industry, and there has been a significant decline in university level education in forestry in Australia. Modern forestry is a highly knowledge intensive undertaking, encompassing a cross-disciplinary education. We are competing against other regions such as Latin America, Asia and even Africa for future investment flows. Given that forestry is effectively a perpetual, renewable industry – and likely to provide a basis for a wide ranging and ever expanding set of markets for energy, materials and ecosystem services – there is a strong case for public support for research and education programs.

The Role of Forestry in Australia's Emission Reduction Initiatives

Finally, we wanted to comment on the role of forests and forestry in our efforts to address the threat of global climate change. We welcome the initiative of the government to establish a carbon price signal in Australia, and we welcome the Carbon Farming Initiative (CFI) as a vehicle to secure a financial incentive for carbon sequestration and storage in forestry and agriculture. Timber is our lowest embodied energy building material, fully bio-degradable, recyclable and produced from a renewable natural production system. Australia's timber plantations have absorbed hundreds of millions of tonnes of carbon dioxide during their growth. Maintaining this plantation timber estate and expanding it seems an important part of managing Australia's carbon balance.

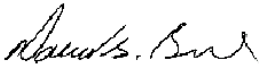
Given the importance of the issue, we have some specific suggestions that will both enhance the attractiveness of forestry to institutional investors and support Australia's climate change goals. We believe that all plantation forests established on previously cleared land should be eligible for crediting under the CFI. Concepts of financial additionality are impossible to prove, and many of the plantations currently being sold from the MIS sector to institutional investors, for example, are marginally commercial. In fact the government must consider some mechanism to encourage investors to undertake second and succeeding rotations for much of the MIS estate or it will likely be converted back to agriculture with the consequent net emission of tens, or even hundreds, of millions of tonnes of carbon dioxide. Certainly some of the MIS estate was established in areas too remote from markets or in conditions too dry for commercial forestry in hindsight. However, there is a very large grey area where plantations may or may not be maintained depending on market conditions. In these areas, establishing a crediting regime for the carbon sequestration in a second rotation could be the key factor in stabilizing the timber plantation estate at a reasonable extent.

Finally, the critical role of forestry plantations in supporting a transition to a low emissions economy should be recognized in government policy. Australia is a large country with low population density and a huge

capacity to grow biomass based industries around energy farming, charcoal and bio-char, sustainable liquid fuels, bio-materials like bio-plastics and biodegradable resins, timber, pulp and paper, flooring and furniture. This could be a critical competitive advantage to Australia in an emissions constrained future. The Government should consider some form of dedicated biomass industry economic incentive program that might support innovations around new bio-industries or new plantation regimes that would foster Australia's ability to lead the way in this new economy.

Thank you again for the opportunity to provide these comments, and we wish you well with the deliberations of this important inquiry.

Yours sincerely,



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