Dear Sirs,

Exposure Draft – The Valuation of Forests

On 16 November 2012 the IVSC announced the release of draft valuation guidance for commercial forests.

An Exposure Draft was issued seeking a response from interested parties by COB 14 February 2013.

The New Zealand Valuation Standards Board comments (red) in response to the questions are detailed below: (not all questions are responded to)

Question 1:

Do you consider that the principles discussed in this TIP could have wider application beyond the indicated scope? If so, please indicate the additional purposes to which the TIP could be applied.

The concepts and principals detailed in the TIP could also be used for potential investors to determine the feasibility of a potential project. The concepts of future costs, cashflows, and time value of money would also assist laymen considering planting a forest, with determining their future cashflows, and the scale/appropriateness of their undertaking.

Question 2:

i) Please indicate your experience of different standards or techniques that are applied in preparing forest inventory, and the markets in which these are applied.
In our experience significant data is collected during the tending stages (pruning and thinning quality control data collected during years 5-12). Specific inventory is also collected at mid-rotation (years 12-17), and pre-harvest (years 18-25).

While QC data is useful for tweaking a stands expected growth characteristics, it is often collected in a over a period of time, and target levels of precision are not the key driver of the inventory method. As such, the data may give you a guide, but the precision is sometimes a limiting factor.

Mid-rotation and pre-harvest inventory is usually planned to achieve a high enough level of precision to make decisions based on this information robust. For this reason MRI or PHI is preferential when valuing forests older than 15 years.

ii) Do you believe that it would reduce diversity of valuation practice if the IVSC gave more information on common sampling and measurement techniques?

No we do not believe it would reduce diversity. The TIP is a guide; forestry consultants will determine the availability of data, and can analyse firstly how sensitive the value calculation is to this data, and secondly if better quality data is required. NZ already has a best practice guide on Inventory Practice in Managed Forests.

Question 3:

Please indicate which of the methods discussed you most commonly encounter in the valuation of forestry interests. If you encounter more than one on a regular basis please indicate whether there is clear tendency to use different methods under different circumstances, eg:

i) the stage of maturity of the tree crop

The cost approach is more commonly used in younger forest stands with the income approach more common in semi-mature to mature stands. The market approach is sometimes used as a check method where there is sufficient market information available.

ii) whether the valuation is of a single stand or multiple stands

The income approach is more common in multiple stands where different age stands can add value to the overall forest entity.

Question 4:

Are there any other valuation approaches or methods used for valuing interests in forestry with which you are familiar? If so, please describe the method and the circumstances under which it is applied.

When we analyse mid-rotation and near mature forest values, the “optimal” clearfell age is used in the income approach most commonly. We also compare this with an immediate
liquidation value, as often where forestry is not the highest and best use; harvest will occur at an immature age to enable faster conversion of the land into another use.

**Question 5:**

i) In your experience what is a typical range of forecast period for valuing forestry interests, and what criteria are used to determine how long this should be on a case by case basis?

Common forecast periods are 2-20 years. Primarily this is determined by the expected clearfell age (25-30 years). This is primarily for a single rotation of the existing tree crop.

In valuing the ongoing nature of a non-terminal forest estate sometimes a second rotation is also included in the forecast period.

iii) Do you consider that it would be helpful for the IVSC to provide specific guidance on the length of the forecast period?

We do not feel that specific guidance on the length of forecast period would be necessary, but it could be noted that subsequent rotations or extended periods of forecast greatly increase the uncertainty of the outcome.

**Question 6:**

Do you agree with this guidance? If you have experience of how appropriate discount rates can be derived for use in a DCF of a forestry interest please indicate if this differs from the proposed guidance.

We agree that greatest weight should be given to market based evidence of Discount Rate. Our experience is that the WACC and CAPM are poorly understood, and incorrectly applied in many cases.

We believe that calculation of IDR is a more appropriate guide in determining the income based value of forestry assets. Although this relies upon the consultants inputs into the individual sales analyses, these can be made consistent with the valuation practice of the subject forest. This will still result in significant variations still in IDR’s and this is to be expected as there are few potential buyers of forests, and information guiding them is often limited.

The depth of knowledge of the forest valuer with regards to these past market transactions will provide the “value” proposition of that valuer to potential clients. In-depth knowledge of past transactions will guide the valuer as to what discount rate to use based on the spread of IDR’s and individual details of each sale.
Question 7:

Please indicate if you agree with the proposed guidance on the applicability of the cost approach. If not please explain why by reference to practice in the markets with which you are familiar.

Question 8:

i) Please indicate if you have encountered a similar problem to that described and, if so, any reason or justification given for the change in value?

Similar problems are likely to occur during any forest lifecycle. As discussed the cost based approach is more appropriate where future growth is less certain at young ages, and where a similar forest could be recreated on a different site by a potential investor planting their own forest. The forest will then age until at some stage the forest is more appropriately valued using a future income approach with applied discount rate.

At the point where the methodology changes, significant value changes can occur.

The reason/justification is as described in this TIP.

For an estate with multiple age classes the methodology can include both cost and income based stand values. Each stand therefore over the long term will progress from Cost-based value (say age 1-7), to income based value (say 8-harvest), and back to cost based at the start of the next rotation etc.

ii) Do you consider that the guidance provided on the need to consider an alternative method in the Exposure Draft addresses this issue?

Yes.

Question 9:

Please indicate if you have experience of a separate value being ascribed to the “biological asset” in a forest for financial reporting purposes and, if so, the method or methods that you are most familiar with to arrive at this value.

We commonly ascribe a separate value to the biological asset in a forest, using the approaches described in this TIP.

We never encounter the situation where a forest value is ascribed without determining it from the components of land, trees, other improvements.

Transaction evidence in NZ does not support direct forest value comparisons (due to lack of closely similar forest sales to the subject forest), so the Forest Value less Raw Land Value does not occur.
This approach may soon become available in NZ as forests of similar size, similar location and similar soils/topography come on the market. Many of these forests were planted in 1993-1997, and involved farms being subdivided into 20-40ha lots and all planted with the same stock at the same time.

**Question 10:**

In the context of the requirement to ascribe a fair value to the biological asset as required by IAS 41, which of these views do you support?

Where the biological asset and land are held in one ownership then the value of any improvement be they biological or structural is the added value it gives to the land. Therefore in valuing a forestry asset the market value of the land should be deducted from the total entity value to arrive at the value of the biological asset. Whilst the biological asset may produce income at a future time the added value of the asset if liquidated at the date of valuation may result in a negative or zero value. Therefore I cannot agree with the statement made at clause 65 which in effect medals with the value of the land (where a higher and better use is anticipated) in favour of the biological asset value.

We cannot agree entirely with clause 65. It also may be entirely consistent to value the land at its higher and better use where overall (at the time of valuation) the entity has a higher and better use as forestry. By way of example is if a single stand forest is mature and awaiting harvest and the land has a higher and better use it would be entirely consistent to value the land at its higher and better use as it would be available for the use immediately upon harvest of the forest crop. A slight adjustment may need to be made to reflect time periods that may be appropriate on the crop value.

Where the biological asset and the land asset are held in different ownerships then the value of the land may be impaired by the terms of the lease, license or forestry right and the lessor’s or licensor’s interest will be valued. The value of the biological asset may be influenced by the rental paid or stumpage percentage to be paid on harvest. Where the rental paid is a reflection of a potential higher and better use then it may result in a zero value on the biological asset. Conversely if the rental paid is less than that expected for a forestry investment and the value of the biological asset may be enhanced.

In valuing the separate interests there may be a land valuer and the forest valuer employed. Care must be taken that the assessed biological asset value when added to the land value does not place a value in excess of the market value when combined.

However this is not saying that in certain circumstances the value of the biological asset held separately to the land asset and vice versa may equate to value in excess of the freehold asset as if held in one entity. This may be because of the tax advantages (in certain jurisdictions) to either party in the structuring of the separate interests.
Question 11:

i) Do you consider that these examples will be helpful in reducing diversity in practice?

ii) Are there any other subjects that you consider would benefit from an illustrative example?

Question 12:

i) Please indicate whether you believe that the draft meets these objectives. If you disagree please indicate why and how the guidance could be improved.

ii) Are there any additional matters that you believe should be addressed? If so please indicate what these are.

Yours faithfully,

Chris Stanley
Chairman
Valuation and Property Standards Board