INTRODUCTORY COMMENTS

1. Thank you for the opportunity to submit on the International Valuation Standards Council (IVSC) Exposure Draft – The Valuation of Forests.

2. Thank you also for granting an extension of time for making this submission.

3. In this submission, the New Zealand Institute of Forestry recommends that the International Valuation Standards Council should not release The Valuation of Forests: Exposure Draft without significant revision.

ABOUT THE SUBMITTER

4. The New Zealand Institute of Forestry (NZIF) was founded in 1927 and has 850 members who are the individual professionals in forestry in New Zealand. Its object is to advance the profession of forestry in New Zealand and to be an independent advocate for forestry. NZIF is committed to serving the practice of forestry and the wider community through education, accountability and its code of ethics and performance standards. It fulfils a quality assurance role, setting the benchmark for professionalism and the quality of advice and practice by which members and others in the profession are measured.
5. NZIF members are concerned with the professional management of all forests, plantation and natural, conservation, protection and commercial. They can be found in forestry companies, consulting businesses, research institutes, educational facilities, government departments and providers of specialist services. The members’ qualifications and areas of expertise reflect the diversity of disciplines involved in managing a modern forest resource from traditional forestry degrees through science, economics, law, micro-biology, hydrology, engineering and resource management. The NZIF operates the scheme that controls the registration and conduct of New Zealand forestry professionals, including consultants who provide forestry advice to the public.

SUBMISSION

6. The NZIF commends the IVSC for tackling the complex issues involved in the valuation of forests. We know from our own experience in developing the NZIF Forest Valuation Standards and of our knowledge of the Standard for Valuing Commercial Forests in Australia developed by the Institute of Foresters of Australia (IFA)/Association of Consulting Foresters of Australia (ACFA) of the complexities and difficulties associated with such an exercise.

7. The NZIF has seen and supports the submissions that IVSC has received from Professor Bruce Manley and Mr Bill Liley, both of whom are NZIF Registered Members and members of the NZIF Valuation Working Party. Professor Manley has been the Convenor of that Working Party since it was established in 1993. He is also an elected Fellow of NZIF in recognition of his status within the forestry profession in New Zealand.

8. The NZIF has also seen and supports the comments you have received from the IFA/ACFA and from Mr Jerry Leech of the ACFA. NZIF and the IFA have close links and cooperate on many forestry issues of common interest.

9. In view of the detailed comments you have received from others in New Zealand and Australia, we have not commented in detail on the Exposure Draft. Rather we have chosen to:
   9.1. Describe some of the history and drivers of forest valuation in New Zealand;
   9.2. Describe some of the background to the development of the NZIF Forest Valuation Standard;
   9.3. Use this historical context to make some general observations and recommendations for further development of the material in the Exposure Draft.

FOREST VALUATION IN NZ – A SHORT REVIEW

10. Forest valuation has a lengthy history in New Zealand. By way of example, the New Zealand Journal of Forestry (published by the NZIF) Volume 31(2) 1986 included a review of Valuing Forests and Forest Land in New Zealand: Practice and Principles by T. Fraser, G.P. Morgan and G.R. Watt (FRI Bulletin 99, 1985) that was an update of a similar 1978 paper, Principles and Practice of Valuing Forest and Forest Land in New Zealand by G.R. Watt and T. Fraser (FRI Economics of Silviculture Report 115, unpublished).

11. Forest valuation methods came under very considerable scrutiny in New Zealand following a 1985 decision of the NZ Government to transfer its commercial plantation forests and associated assets to a State enterprise that was to be established for this purpose. These forests comprised around 550,000 ha of plantations of forest species that had been introduced to New Zealand and represented, at that time, approximately half of the plantation forest resource in New Zealand. The price the State enterprise was to pay for the forests, land and associated assets was to be a market value determined as between a willing buyer and willing seller.

12. Individual forests ranged in size from very small to thousands of hectares, they contained a wide range of species and age groups, they were located on a wide range of sites from flat land to steep and sometimes very erosion prone topography and geology. Distances to markets and export ports and the availability of roads suited to cartage of logs varied widely.
13. Fortunately, reasonably good forest data (down to detailed treatment history at individual stand level) were available, as was a suite of interconnected computer systems that linked the stand record data, inventory systems, growth models and other predictive tools plus stand and forest modelling tools (with options for both simulation and optimisation). These had been assembled as part of a joint management and research project team assembled in the mid-1970s. These tools have been refined over time.

14. Determination of the value involved detailed analysis and research into methods of forest valuation, practices followed in other countries, the critical parameters in valuations, etc. What transpired was that the proposed sale was somewhat unique and precedents as to how the value should be determined were negligible or non-existent. This led to even more analysis and negotiation between government officials and the Establishment Board and staff of the new enterprise. While it was generally accepted that a discounted cash flow method of calculating the value would be used, other scenarios (such as immediate liquidation) were also analysed to test the reasonableness of the values being derived.

15. The sensitivity to two particular parameters, discount rate and assumptions on log prices and future movements in log price became absolutely critical to the value – small changes in either could cause very significant changes in the calculated value.

16. The valuation was also complicated by a condition in the proposed sale that would require the State enterprise (or a subsequent owner) to sell the forest on a specific area of land, and the land, back to the government should it be successfully claimed by Maori (the indigenous people of New Zealand) under legislation dealing with former injustices. The parties needed to determine just what impact this condition might have on value. It was important in the context of security of tenure to the trees because it constrained the ability of the tree owner to enter into long term supply contracts.

17. After several months of unsuccessful negotiation, the government determined rather than selling the forests it would instead privatise the forests and let the market determine the value. At the same time the government determined the land would not be sold, but a new form of land use right would be introduced in which security of tenure to the trees was a key consideration.

18. In preparation for the sale, the government calculated its expected value (essentially based on a willing but not over-enthusiastic seller). The government’s values were not disclosed to bidders (although many bidders would have been aware of the previous negotiations and some of expectations the government might have. Bids were only accepted by the government when they came within the acceptable range established around the government’s values. It took several rounds of bidding over a two year period before all the forests were sold, the final sale taking place in May 1992.

19. The sale process was a significant step in advancing knowledge of the issues around forest valuation in New Zealand.

20. As mentioned above, it was established that assumptions about log prices to be used in a valuation could have a significant effect on the estimated value. In the valuations in the period from 1986 up to the last sale in May 1992 there was general acceptance that the starting point should be based on the prevailing prices at the date of valuation (and variants included the actual prices at the time the valuation was prepared and the average over the three years prior to the valuation). More debatable were the assumptions about future prices and here there was significant divergence from no change from existing prices in real terms to escalation as much as 3%/annum in real terms. The parties each claimed analysis of long term price trends, predictions of supply and demand for wood over the short to long term, etc., supported their approach.

21. What actually happened is demonstrated by the graph of quarterly export log prices from March 1992 until September 2005 (unfortunately a comparable price series from earlier than 1992 was not readily available when preparing this submission). Export prices are very important as actual and potential production from NZ’s plantation forests greatly exceeds domestic demand. If the production is to be used, around 70% has to be exported in some form, processed or unprocessed.
By late 1992 as export log prices rapidly increased the government was accused of having “given away” the forests and a wave of speculative forest investment followed as shown in the second graph. Much of the new forest establishment in this period was initiated not by the government or the established forestry companies, but by individual land owners, partnerships, etc., generally in small holdings. It now makes up a significant forest area and will increasingly influence the potential supply of logs from 2020 onwards. It is likely to have an effect on forest values.

NZ EXPORT LOG PRICES

22. However, by late 1993, prices peaked and rapidly dropped away, until at the end of the period shown, prices for most grades in nominal terms, were less than those applying at the beginning of 1992. The actual trend in prices was not something anyone had predicted during the valuation negotiations.
23. The price decrease was followed by a considerable decrease in investment in new forests – a trend that was exacerbated as the government started discussing options for climate change mitigation, discussions that culminated in the introduction of an Emissions Trading Scheme (ETS), with forestry as one of the first sectors to be included. The impact of the ETS has also had to be factored into forest valuation practice in NZ.

24. What the above discussion demonstrates is the extreme difficulty of making correct assumptions around some critical parameters in a forest valuation and of correctly predicting and catering for changes in government policies and regulation.

THE NZIF FOREST VALUATION STANDARD

25. In 1993 the Council of the New Zealand Institute of Forestry, concerned at the wide range of valuation practice evident in New Zealand, established the NZIF Forest Valuation Working Party. In August 1994 a Discussion Draft set of Forest Valuation Guidelines was released and submissions invited. A substantially revised Exposure Draft was released in October 1996 and again submissions were invited. The NZIF Forest Valuation Standard was released in May 1999.

26. Since 1999 the main functions of the NZIF Forest Valuation Working Party have been:

   26.1. To review and revise the NZIF Forest Valuation Standard to ensure that it remains relevant to the valuation of plantations in New Zealand;
   26.2. To extend the NZIF Forest Valuation Standard to ensure that it is comprehensive in the coverage of valuation issues;
   26.3. To liaise with other interested parties both in New Zealand and overseas.

27. Key outputs have been:

   27.1. A Technical Practice Note in 2007 on the implications of accounting standard NZ IAS 41 for forest valuation;
   27.2. A discussion document in 2007 on recognising the cost of land in the valuation of a tree crop;
   27.3. A discussion document in 2010 on the use of a cost-based approach to value young stands;
   27.4. Guidance material in 2011 on how to incorporate the impact of the Emissions Trading Scheme on forest and forest land valuation;
   27.5. A revised standard in 2012 on Forest Valuation Method.

28. These outputs have been developed with appropriate input from other professional bodies including the Property Institute of New Zealand (which incorporates the NZ Institute of Valuers) and the Institute of Chartered Accountants of New Zealand (particularly auditors of forest value).

29. Since 1997, the NZIF Forest Valuation Working Party has conducted and published in the NZ Journal of Forestry a survey of discount rates used in forest valuations in New Zealand, with some data from Australia also included. The two-yearly surveys have also included questions on log price assumptions, treatment of overhead costs, treatment of land, etc. Information from these surveys has helped to identify issues being faced by forest valuers in New Zealand and Australia that have needed to be addressed in the NZIF Forest Valuation Standard.

30. Use of the NZIF Forest Valuation Standard is compulsory for NZIF members conducting forest valuations in New Zealand.

SUMMARY

31. The foregoing discussion on forest valuation in New Zealand and the development of the NZIF Forest Valuation Standard demonstrate:
31.1. The long history of forest valuation practice in New Zealand;
31.2. The kind of issues that have arisen in forest valuation, some of them very complex;
31.3. The need for regular reviews of the application of any forest valuation standard to deal with difficulties or issues that arise from its use;
31.4. The need to incorporate new matters (such as the NZ ETS) that arise from factors such as changes in government policies, legislation, etc.

32. Our experience has shown the value of involving practicing forestry professionals in the development of forestry standards, including valuation. This ensures that what emerges reflects the reality of dealing with the complexities encountered in forest management and the time horizons involved (generally considerably longer than most assets). It also ensures that the management strategies that are modelled as part of the valuation process are realistic and take into account the practicalities of the scenarios used.

33. We believe that the NZIF Forest Valuation Standard, incorporating as it does the long history and experience of forest valuation practice in New Zealand should form a solid basis for any forest valuation standard being developed for forests in other countries.

34. The *Standard for Valuing Commercial Forests in Australia* published by the Institute of Foresters of Australia Ltd., Association of Consulting Foresters of Australia Division has undergone a similar history and development to the NZIF standard. Those developing that standard have had to deal with similar (not always identical) issues and it also provides a useful precedent that has undergone a lengthy period of “road testing”.

35. Accordingly, the NZIF is disappointed to see that the exposure draft does not deal adequately with some of the key issues that arise in forest valuation – issues that have been identified and then dealt with in both the New Zealand and Australian standards.

36. This leads to an NZIF concern, should the Exposure Draft be accepted by the international community, there might be some pressure from valuers, accountants, auditors and others for it to be accepted in New Zealand and possibly imposed on forest valuers in New Zealand. We contend that would be a backward step and lead to extensive submissions, representations, analysis, etc., as the issues we have already dealt with arise again and again and need to be resolved in the international standard.

**RECOMMENDATION**

37. NZIF recommends to the International Valuation Standards Council:

37.1. The Exposure Draft should not be released in its current form;
37.2. An analysis of the differences between the Exposure Draft and the New Zealand and Australian forest valuation standards (and any other operative standards from other countries) should be conducted to determine the differences and to understand the reasons for those differences;
37.3. The Exposure Draft is revised to ensure it incorporates the experience and knowledge that is already embedded in the currently operative standards (essentially to save the need to reinvent the wheel);
37.4. The revised Exposure Draft is re-released for comment. Steps should be taken to ensure that the professional forestry associations in countries around the world are aware of the document and that they have adequate time to make submissions on it;
37.5. The Exposure Draft should specifically refer to the NZ and Australian forest valuation standards (and others that may exist) and provide that forest valuations in those countries or in other countries where NZ/Australian forest professionals may conduct valuations, should follow the relevant NZ or Australian standard to avoid being in breach of the rules of the professional associations to which they belong.