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RESEARCH
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THE SAD STORY OF FORESTRY AS AN INVESTMENT ASSET IN NEW ZEALAND – Part 3 : THE BEGINNING OF THE END

This is the third instalment in a four-part obituary for the listed NZ forestry sector. Today we will review the sale by the NZ Government, in 1996, of the Kaingaroa Forest to the Central North Island Forest Partnership (CNIFP) and venture that the unintended consequences of this decision were in part responsible for the demise of added value processing in the forestry sector in NZ. We will also estimate the return that the forest has produced subsequent to its sale and then compare that number with the return accruing to the NZ Government who used the proceeds to reduce debt. The latter return is thus determined by looking at the resultant lower interest payments on government debt. The final article will calculate the returns derived from Kaingaroa by the Harvard University Endowment and subsequent shareholders including the NZ Super Fund. Harvard managed to purchase the forest at a "bargain price", apparently less than half what the CNIFP paid seven years earlier, when that entity went into receivership in 2001.

First off though we will review the changes in ownership of the Kaingaroa Forest from its early days as a state asset in the 1960's through to 2014 when its ownership stabilized at the NZ Super Fund (42.5%), the Canadian Public Sector Pension Investment Board (55.5%) and six Central North Island iwi (2.5%).

The privatization of Forestry Corp's Kaingaroa forest occurred on 21 August 1996 when Finance Minister Bill Birch announced the sale

Timeline of Ownership

Year	Ownership
1960s	Kaingaroa Forest was owned by the New Zealand government as a state asset, managed under the New Zealand Forest Service as Kaingaroa State Forest.
1980s	The New Zealand government initiated plans to privatize the forest, separating land ownership from cutting rights under the 1989 Crown Forest Assets Act; cutting rights were sold, but land remained in Crown ownership pending Treaty of Waitangi claims.
1996	The Central North Island Forest Partnership (Fletcher Forests, China's Citic, and Brierley Investments) purchased the forest estate from the government; the partnership later went into receivership in 2001.
2003	Harvard Management Company (Harvard University's endowment fund) forms the Kaingaroa Timberlands partnership to acquire the cutting rights from receivership.
2006	The New Zealand Super Fund (NZSF) purchased a 20% stake in the forest from Harvard. (Cost NZ$300m)
2007	The New Zealand Super Fund (NZSF) purchased a 10% stake in the forest from Harvard. (Cost US$100m)
2008	The New Zealand Super Fund (NZSF) purchased a 10% stake in the forest from Harvard. (Cost US$110m)
2009	The land was transferred to the landowners.
2013	Ownership of the forest changes: NZSF (40%), Harvard (30%), and Canadian Public Sector Pension Investment Board (PSP) (30%) after PSP bought a portion of Harvard's stake.
2014	Ownership of the forest changes again, when Harvard exits. Kakano Investment Limited Partnership (Kakano) is formed and acquires a 2.5% ownership interest in the forest while PSP and NZSF increase their stakes to 55.5% and 42.5% respectively.
	Source: Kaingaroa Timberlands Partnership

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of the forest to a consortium, known as the Central North Island Forest Partnership, comprising Brierley Investments (25%), the Chinese Government investment arm (37.5%) and Fletcher Challenge Forests (37.5%). The government's valuation of Kaingaroa used a DCF model applied to the forest crop – the cutting rights only, as the land was retained by the Crown and it used a pre-tax real discount rate of 8%. Finance Minister at the time Mr Birch said that the $2.026 bn was a very good price and that the net proceeds to the Crown after repayment of debt would be $1.6bn. He went on to say that "this will save taxpayers about $144m per year in debt servicing" and noted that the consortium had received no special tax concessions. Whilst the sale price looked astute in the short term, it hasn't turned out so well for NZ taxpayers over the long term, despite the optimistic comments from the Finance Minister. Mr Birch also talked up the fact that the consortium intended to invest $260m over the next eight years in new state-of-the-art wood processing facilities which would add considerable value to "the 22,000 logs currently exported raw through the Port of Tauranga every week".

That was the "spin" at the time. Now let us look at the reality: the Government sold in 1996 for $2.03 billion and as at June 2024 the forests were valued at $5.75 billion. Using the accounts of Kaingaroa Timberlands Limited (KTL) I built a simple internal rate of return (IRR) model to calculate the return of Kaingaroa, given the initial price which CNIFP paid, the valuation in 2024 and various dividends paid to shareholders over that time. Unfortunately KTL weren't willing to disclose details of dividends paid in the period from 2004 to 2012 so I have assumed the same level of distributions were made in each year in that period as the annual average paid in the 2013-2024 period. Similarly the accounts for CNIFP were never, as far as I know, made public so I needed to make an assumption as regards distributions in the 1996 to 2004 period as well. I have assumed that the distributions over that period, 1996 to 2012 averaged the same $120 m per year as in the period 2013 to 2014. Whilst that may or may not be optimistic I have also assumed that the investment was funded with 100% equity, which is obviously conservative. Given all those assumptions the estimated internal rate of return on the investment in Kaingaroa was 7.8% pa. When the government sold Kaingaroa it was funded with around 20% debt. With gearing at this level the return on Kaingaroa rises to 9.4% pa. We can thus calculate the opportunity cost of selling Kaingaroa by comparing the return the government could have earnt by keeping the forest with the return it actually achieved by using the sale proceeds to reduce borrowing costs. If we look at ten year bond yields as a proxy for government borrowing costs over the period 1996 to 2024 they have averaged 4.83% pa, well down on the 7.9% pa prevailing in 1996 when the sale was completed. So an admittedly very approximate comparison, and one which also ignores risk, is that the Government sold an asset which generated a return of 9.4%pa to reduce borrowing costs of 4.83% pa, in other words an opportunity cost of 4.57% pa. Not a great deal for tax payers, I'm thinking, but vastly better than selling the electricity companies.

Whilst the economics of the sale were not, in hindsight, compelling that transaction and the unintended consequences thereof look to have contributed to the demise of the forest processing sector in New Zealand. It is above my pay grade to distinguish between the relative impact of market forces versus ownership as regards the decision as to whether to engage in value add investment decisions or not but it may be that the downstream impacts of selling Kaingaroa, were more consequential to the net present value of New Zealand than the opportunity cost of the sale. We won't even get into a discussion of how much tax the partnership has paid.

The first mistake was selling Kaingaroa to a highly leveraged entity – the high borrowings of CNIFP, when combined with the volatility of log prices in NZ dollar terms meant that CNIFP was potentially an accident waiting to happen. Instead the government should not have sold all of Kaingaroa in one transaction and should have taken equity in the partnership on condition that the leverage of the new company could be no higher than that which the government had deemed reasonable when it owned Kaingaroa, ie not more than 20%. This structure would have enabled the government to influence policy as regards further domestic processing and obviously ensure that ownership did not fall into overseas hands. Instead the government sold at $2 billion and then progressively bought back into Kaingaroa, via the New Zealand Super Fund, at higher prices. Additionally, the Super fund is in the business of maximizing returns for itself rather than fostering a diverse and growing domestic export oriented economy and thus advance skilled employment in New Zealand. So arguably the Super Fund has very different investment objectives than the NZ government. Whatever the reasons, the increase in wood processing which Mr Birch spoke of hasn't kept pace with output with the result that whilst, "*22,000 logs are currently exported raw through the Port of Tauranga every week*" back in 1996, today, according to ChatGPT, some 400,000 logs leave unprocessed each week via the Port. However it has been suggested that NZ typically exports lower-grade (industrial) logs and these are often unsuitable for structural uses domestically, so exporting unsuitable grades complements rather than competes with the domestic timber industry.

Brent Sheather is a Financial Advice Provider. A disclosure statement is available upon request. Brent Sheather may have an interest in the companies discussed.

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