processing and market penetration, alleviating concerns over the supply of capital to process the 'wall of wood' opportunity. Other options exist for the released capital, such as in a recent example where a capital distribution was made to the shareholders in a public company following the sale by the company of forestry rights to institutional investors.

- Secondly, markets are more transparent because TIMOs investments are rarely leveraged, so they can respond to market signals in their harvest planning without the necessity to meet cash flow hurdles or other corporate or bank imposed constraints by harvesting at an inappropriate time.

- Thirdly, TIMOs expand the number of suppliers of stumpage and/or logs to the open market. Though the seller may negotiate a wood supply contract such commitments will not extend to the full woodflow available. The availability of open market wood in all grades to all processors adds to the competitiveness and depth of the wood supply market in New Zealand. UBS Timber Investors is the largest TIMO in New Zealand with a current gross area of 115,000 productive hectares and associated woodflow of some 2.1 million cubic metres per annum. These assets represent a significant market volume from a now independent and non-integrated supplier. This allows independent processors who specialise, say, in extracting value from pruned logs, to expand their capital investment with the assurance that an independent and sustainable supply of quality logs will be available to the most efficient competitors.

- And fourthly, TIMOs are generally small and focused organisations staffed with specialists. TIMOs generally contract the services that are needed to manage and market the assets they control. UBS Timber Investors prefers such contract arrangements, and for our New Zealand properties contracts the day-to-day management either to the joint venture partner, or the vendor or to independent forest management companies. Particularly in New Zealand, this has assisted the emergence and sustainability of service providers in such areas as forest protection and management, harvest planning and execution, marketing and appraisals. The forest industry in New Zealand is richer for the energy and commitment from these independent service providers.

In creating these advantages to the forest sector in New Zealand, TIMOs also bring with them certain disciplines that need to be understood. TIMOs represent their clients and are absolutely focused on realised investment returns. Whilst the early years of the TIMO industry may have included some transaction-driven individuals, the standard now is for a disciplined team approach focused on the financial risks and outcomes of the proposed transaction. Investment return must be driven by the realised cash flow and not rely on appraised valuations, which can be erroneous. Historically, over-reliance on appraisal value has masked the true volatility of timberland investment and has led to inappropriate management strategies. TIMOs have no interest in rescuing those companies that have chosen to overvalue their plantation assets.

The TIMOs have landed! New Zealand has provided an attractive geography for forest investment, but it is not the only one available to the global investment management industry. The New Zealand forest industry must continuously improve its global competitiveness else the capital will flow, very freely, to other countries offering a better matrix of risk and return. The New Zealand forest industry has a constant challenge to ensure the TIMO partnership continues. I personally hope that this challenge is accepted.

Bigger role for smaller growers

Denis Hocking*

Most land based primary industries would appear to have a fair bit in common. You grow things, then harvest, process and market them. Regardless of whether the product is wood, milk, meat, wool, or arable crops the basic theory is much the same. So it is surprising that the commercial structures for these industries are so different. In forestry vertically integrated companies seem to have been accepted as the dominant industry players, while farming has always been based on the family farm, but with markedly different processing and marketing structures beyond the farm gate for the different products. If you are looking for parallels, the New Zealand dairy industry and parts of the Scandinavian forest industry might be the closest.

While New Zealand pastoral industries have seen numerous examples of farmers owning the processing and marketing sectors, mainly through cooperative structures and with varying levels of success, we have not seen successful examples of processors owning the farms. Indeed, corporate farming structures in New Zealand, have, almost without exception, failed (is Landcorp really a corporate?) and the family farm structure has continued, sometimes with quite a few bells and whistles. The reason might be debated, but I believe key reasons are the combination of motivation and acceptance of capital accumulation as an alternative to cash flow. In other words, land prices are too high to ensure adequate cash flow returns.

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So why the difference in forestry? It may be largely cultural. As my father was fond of saying, back in the days when the NZ Forest Service ruled the forestry roost, ‘we come from a pastoral rather than silvicultural culture’, where livestock farming was a noble calling and growing trees was left to the State and a few companies. Attitudes have shifted in recent years but the hoped for transition to a balanced approach to land use, where a family forest might be seen as much the norm as a family farm, is far from complete.

However, on the other side of the equation, we are seeing the major forestry Corporates struggling with their plantation operations. Fletchers are selling off forests and Carter Holt Harvey have been achieving poor returns here and appear to have abandoned value adding in the forest growing phase in favour of adding value through processing.

This shouldn't come as too much of a surprise. I am not the only one who regards a publicly listed company as a lousy vehicle for growing forests. Forest growing is, in the broader sense, a capital or asset forming rather than a cash flow business and even in a mature, sustained yield situation, there is far too much temptation to run down the forest value (by over-cutting or reducing silviculture) to maintain cash flow and share prices in the face of commodity cycles and product price fluctuations.

In theory, private ownership should handle these cycles better than listed companies that have to confront disgruntled and probably ill-informed shareholders. Certainly, the family farm survived the restructuring and crises of the 1980s under conditions that would probably have sunk listed companies, though the dairy industry may currently need a reminder of the art of riding commodity cycles.

With the present tax rules, farm forestry provides a very good tax-deductible investment for those occasional, awkwardly high farm profits. It can be done when the profit or capital is available, though in a farm situation a small amount of capital can cover a surprisingly large area in trees. It is certainly a far more rational and productive tax avoidance scheme than the traditional new tractor.

If there are advantages in private ownership, there also have to be some disadvantages in having forest resources tied up with small growers, including the likelihood of a more lumpy wood flow reflecting log prices. However, for those worried about security of log supply for processors, remember that numerically, the majority of sawmillers do not own forests. Longer term supply contracts are certainly quite feasible and there are a number of ways in which wood flows from a number of small growers could be and, in some cases already are being aggregated. Cooperative marketing is one option, but there are good log brokers already doing this job very effectively. In my opinion, the bigger problem is getting the majority of woodlot owners to give their plantations the priority and attention they deserve, or in other words to complete the cultural transition mentioned earlier.

Another feature of small growers is their enthusiasm for a variety of alternative species. They will grow cypressess, eucalypts, blackwoods, redwoods, etc., etc. regardless of what the bean counters may have to say about the commercial viability of such ventures. The financial aspects may not be entirely ignored, but the enthusiasm for something different is probably the more important driver. I think the rest of the industry should welcome this aspect. It will provide limited quantities of some superb timbers and can already provide a lot of information and experience about a wide range of species.

So, from an admittedly subjective viewpoint, this is my list of some of the advantages and disadvantages of having forest growing dominated by small growers:

**Advantages**
- Potentially lower growing costs through use of lower opportunity value land, labour and capital.
- Better overall land use through matching of land use and soils, land form, micro-environment, etc.
- Less incentive to cut costs now.
- Greater acceptance of plantations as growth assets rather than cash cows.
- More opportunity for a true market to operate.
- More even distribution of forests, perhaps not seen as an advantage by all, but some clustering of the forest resource is still probable.
- Commercial and soil conservation advantages for land owners.
- Processors left to invest in processing.
- Wider range of species.

**Disadvantages**
- Not all woodlot owners give adequate priority to their trees.
- Higher harvesting costs on some/many small blocks.
- Inadequate roading including on-farm roading.
- Variations in log quality.
- More erratic wood flow.

And the verdict? Well that has to depend on the jury, but rest assured that the best plantations I have seen have all been owned by small growers and the most attractive woods have been some of those alternative species, cypressess, eucalypts, blackwood, etc., grown by farm foresters. Putting more of the forest resource into the hands of the small grower is very unlikely to be to the detriment of New Zealand forestry and could be very much to its advantage.