

Collective Harvest by Joint Venture

For Forest Enterprises Managed Investment Schemes



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Forest Enterprises is the business name of Forest Enterprises Growth Limited and its subsidiary Forest Enterprises Limited. Forest Enterprises Limited is licensed to manage Managed Investment Schemes (excluding managed funds) which are primarily invested in forestry assets.

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Executive Summary

Forest Enterprises Limited proposes the collective harvest joint venture solution for those managed investment schemes (Investments) which face the challenges and risks identified if each Investment had to harvest on a stand-alone basis.

As the licensed Manager under the Financial Markets Conduct Act 2013, Forest Enterprises must, at all times, act in the *best interests of the Investors to maximise the return at harvest which includes harnessing the scale and common interests of each investment with other investments managed.*

Objective – Maximise Return and Minimise Risk

The collective harvest proposal is the Manager's solution to meet the challenges and risks identified and our obligation to maximise Investor return at harvest.

Implementation of the collective harvest proposal is in Forest Enterprises' professional opinion the best strategy to maximise the harvest return and minimise the harvest related risks and is consequentially the strategy which is most likely to produce the returns projected for each investment.

Exchange 100% of Own Harvest for Agreed % of Collective Harvest

Fundamental to the collective harvest proposal is each Investment exchanging 100% of the returns projected for the harvest of their mature forest for an agreed % of the much larger collective harvest. The agreed percentage being calculated using the recognised and accepted *Forest Crop Value Methodology* of each forest in the joint venture.

Inherent in the collective harvest proposal is an expectation to *lift the tide*, therefore, to create a greater harvest revenue pool to be shared than the sum of the parts, were each Investment to separately harvest its own forest.

Consequential Requirement for Land LP

There are some collateral consequences arising from collective harvest which impact on each Investment's second rotation forest, and also on certain costs and revenues. These consequences are equitably resolved by the transfer of the land (and consequentially the second rotation forest as it is planted) to a new limited partnership ("Land LP") owned jointly by the Investments in the joint venture.

Similar to collective harvest, fundamental to this solution is each Investment exchanging full ownership of their land for an agreed % ownership of the enlarged joint land. The agreed percentage being calculated using recognised and accepted valuation methodology. Also inherent in the creation of Land LP is an expectation that the combined land area (and second rotation forest) will have a higher market value than the sum of the value of each Investment's land and second rotation forest.

Investment Wound Up at Conclusion of Collective Harvest

Land LP is required to sell the joint land and second rotation forest around the conclusion of the collective harvest. This is to ensure that each Investment can be wound up and the Investors paid out in full following the conclusion of the collective harvest, consistent with the existing underlying Investor expectation.

Future Options Enhanced

A collateral benefit arising from the creation of Land LP is that this limited partnership could become a second rotation investment for those Investors considering this option, whilst still allowing those investors planning to cash up and exit at the end of harvest to do so.



Introduction and Purpose of this Report

The purpose of this document is to set out in one comprehensive report all of the details relating to collective harvest by joint venture. Collective harvest by joint venture is proposed for a number of managed investment schemes (MIS) managed by Forest Enterprises Limited and regulated by the Financial Markets Conduct Act 2013 (FMC Act).

Many parties have an interest in this proposal including the Investors, the Supervisor, the Financial Markets Authority, the Forestry Auditor and the Financial Auditor. These parties will be involved in different aspects of implementation of the proposed collective harvest by joint venture. Ultimately it will be the Investors who decide to proceed or not by a vote. The vote will be a special resolution requiring a 75% majority.

These notes are written from the perspective of the relevant MIS which are structured as limited partnerships.

Genesis for Collective Harvest by Joint Venture

'Wall of Wood' and Other Challenges Identified

Ten years ago, Forest Enterprises was concerned that harvesting as individual forest blocks was creating unnecessary risk for the Investors and not necessarily maximising the financial return. At that time, the forests being harvested were small, had many age classes, and these factors were often resulting in harvest programs of less than 1-year in duration. To a degree the historical problems solved themselves as the forest blocks coming into harvest were generally larger and this scale addressed some of the issues

As the harvest of the large areas of forest planted in the 1990s loomed, Forest Enterprises had to turn its attention to the practicalities of harvesting these areas under the company's management but in an environment where there were also significant other areas of 1990's planted forest outside of the company's management.

It was clear that all post 1990 forest areas (not just those managed by Forest Enterprises) would be competing for -

- Harvest infrastructure - logging contractors, roading contractors, cartage contractors
- Access to sensitive roads - some not able to be used in winter, or with restricted winter access
- Limited domestic market options
- Limited port space for the large percentage of logs that must be exported
- Potentially limited market uptake

Forest Enterprises was also mindful of the increasing impact of changing legislative requirements including -

- Resource Management Act 1991 - the prospect of harvest quotas per river catchment and maximum continuous clearfell areas per annum
- Health and safety regulation - incentivising more machinery and less labour requiring different relationships with harvest contractors who have more capital invested

Forest Enterprises also needed to resolve the impact of some unique factors to many MIS under management including -

- MIS with large forest areas in just two or three age classes - consequentially it is not possible to harvest each age class at the selected optimum age
- Adjoining forest areas across different MIS - many MIS forests are sub-areas of a larger contiguous forest area comprising a number of MIS managed by Forest Enterprises.
This arose from the historical consequence of the legislative environment necessitating the subdivision of farms purchased for investments into multiple MIS. The most efficient harvest will be achieved ignoring these artificial boundaries.
- Vulnerability to access from one public road



Forest Enterprises' Responsibility to Act

Forest Enterprises has been managing forestry investments since 1972 and our success is in large part because of the company's Investor focus. In addition, Forest Enterprises is a licensed manager of forestry MIS in terms of the FMC Act.

Our obligation in respect of each MIS is therefore to act in accordance with the FMC Act, the governing documents, and the Statement of Investment Policy and Objectives (SIPO). This is expressed in section 143 of the FMC Act. It is specifically expressed in 143(1)(b) that *in exercising any powers or performing any duties as manager (the manager) will act in the best interests of the scheme participants.*

It is expressed in the SIPO under *Investment Objectives - Treecrop* that the *investment objective is to maximise the return at harvest and to harness the scale and common interests of the investment with those of other investments managed by the manager to maximise the investment return.*

Forest Enterprises therefore has a legal responsibility to act to resolve the known challenges, in addition to our underlying business focus to achieve the best investment outcome for Investors.

The solution the company has devised is collective harvest by joint venture.

Collective Harvest by Joint Venture

Objectives of Each Collective Harvest Joint Venture

The objective of each collective harvest joint venture is to resolve as best possible the known harvesting challenges and specifically -

- To ensure the forests of each participant MIS can be harvested
- To maximise the opportunity for a better (more profitable) harvest outcome for each MIS
- To minimise the risks for each MIS including crop, access to domestic markets, access to port
- To aim to achieve an average age at harvest of approximately 30 years

The objective is also to endeavour to meet Investors' expectations around timing of harvest, therefore timing of payment of the investment return.

The Collective Harvest Solution

Collective harvesting as a joint venture has no regard to each MIS's forest boundaries. Instead harvesting is focused on the most cost-effective harvest of the entire area of joint venture forest over a harvest period which may be over 10 years.

In most joint ventures, harvesting starts early and finishes late. All other factors being equal, the quantum of stumpage per hectare will be less but early for the younger trees harvested and more but later for the older trees harvested. The balance between early and late harvest is targeted to achieve an average age of the trees at harvest of around 30 years.

Collective harvest in this manner creates the environment for each participant MIS to resolve as best possible the known harvesting challenges and achieve the targeted objectives.

Directly or indirectly, achieving the targeted objectives should translate into increased return or less risk of reduced return from the harvest. Consequentially, agreement by the MIS in each joint venture of the sharing of the total revenue from the collective harvest is a very important component of the joint venture.



Calculation of each MIS's Equitable Share of Collective Harvest

Overview of Collective Harvest Share Calculation

The underlying principle behind sharing the total revenue from collective harvest is that each MIS is better off receiving a percentage share of the total revenue from the collective harvest of the forests owned by the multiple MIS in the joint venture than 100% of the revenue from harvest of their forest.

A sharing methodology is required, and the methodology used is to calculate each MIS's forest crop value at the same date using the same assumptions, and to input the calculated figures into the following formula -

$$\text{Percentage Shares} = \frac{\text{The percentage of each MIS forest crop value to the total of the forest crop values for all MISs in the joint venture}}{\text{Total Forest Crop Value}}$$

Worked example of formula -

MIS Name	Forest Crop Value	Calculation of % Share	Calculated % Share of Collective Harvest
MIS 1	\$10.5 million	$\$10.5/\43.0	24.42%
MIS 2	\$15.0 Million	$\$15.0/\43.0	34.88%
MIS 3	\$17.5 million	$\$17.5/\43.0	40.70%
Total Forest Crop Value	\$43.0 million		100.00%

Forest Crop Value

The benefit of using forest crop value is because the methodology is -

- Prescribed by International Accounting Standard IAS 41, the accounting standard for valuation of biological assets
- Complies with the New Zealand Institute of Forestry valuation standard

The calculation uses a subset of each MIS's projected Cashflow.

The figures in the Cashflow are gross (before tax) and the discount rate used is 3.5%.

Calculation, Checking and Reporting Shares to Investors

Forest Enterprises prepares the forestry and other inputs, enters these into each MIS's Cashflow, and calculates the resulting shares for each MIS in the joint venture.

The assumptions for the forestry inputs are reviewed by the Forestry Auditor (Forme Consulting Group Limited).

Forest Enterprises prepares a report to Investors in each MIS setting out the relevant forestry assumptions, the calculated forest crop values, plus resulting calculated shares of the collective harvest revenue. Supporting this report are the review letters received by the Supervisor from the Forestry Financial Auditors.

The key measure against which the calculated harvest shares is reported is comparison with the percentage of net stocked areas of each MIS in the joint venture. This is because, all other factors being equal, the percentage allocation of harvest to each MIS would be the same percentage as the net stocked area. The differences in the calculated percentage shares is therefore explained and rationalised with reference to the actual hard data relating to valid actual differences between each participant forest in the joint venture.



Selecting MIS for Each Joint Venture

Key Characteristics of each Joint Venture

Collective harvest by joint venture results in multiple MIS forming a joint venture specifically for harvest.

The key characteristics of a collective harvest joint venture are -

- The relationship between the MIS in each joint venture is that of contracted parties
- The nature of a joint venture structure is that a party is appointed the manager - this party is the common manager of each of the MIS, Forest Enterprises Limited
- The joint venture concludes when the last merchantable logs from the collective harvest have been harvested (and the resulting funds distributed to the participant MIS)
- Each participant MIS continues as an autonomous investment entity having exchanged the revenue arising from harvest of 100% of the forest on their land for the right to an agreed percentage share of the revenue arising from the collective harvest by joint venture

Joint Venture not to Undermine Fundamental Character of each MIS

The forestry MIS established and managed by Forest Enterprises since 1972 have embodied a consciously targeted character arising from the following key elements -

- Single rotation investment with harvest occurring at the final stage of the investment period
- A boutique investment for personal not corporate Investors
- An investment which provides personal ownership and control by the Investors
- An investment which can be visited and enjoyed first-hand, rather than intangible assets

The selection of MIS for each joint venture must therefore endeavour to preserve this fundamental character of the MIS and achieve the joint venture's objectives.

Value Added by Forest Enterprises and Fees

A key benefit of collective harvest by joint venture is Forest Enterprises ultimately managing an economic number of substantial collective harvest joint ventures. Each joint venture will be of sufficient scale to attract the interest of major contractors across the gamut of harvesting and log sale service providers. However, collectively these joint ventures are of a scale which enables Forest Enterprises to interact with the service providers as if one major corporate forest owner; this status translates into further economies and value to the joint ventures.

This larger scale also enables Forest Enterprises to attract top forestry professionals to manage the harvest, plus enter into logistics solutions such as -

- The rail yard at Waingawa on the outskirts of Masterton
- The rail operation to transport logs by rail from the Wairarapa to CentrePort in Wellington
- The leased storage space at CentrePort in Wellington

Forest Enterprises' fee for the management of the joint venture is the company's standard harvest management and marketing fee of \$3 per tonne plus 2.5% of the net stumpage (excluding the cost of roading and related infrastructure). No extra fee is payable for the operation of the joint venture as from Forest Enterprises' perspective the joint venture is a harvest management and marketing arrangement for the mature trees owned by each MIS.

An establishment fee is also payable to Forest Enterprises at the time of formation of each joint venture of an amount approved as an element of the implementation vote by Investors. This fee is for the establishment of both the joint venture and the consequential limited partnership for the purposes of owning the land (Land LP) discussed under the heading *Collateral Consequences of Collective Harvest* on page 11.



Legal Documents Required for Joint Venture

Overview

The collective harvest by joint venture operates within a legal structure comprising the following two documents -

- Joint Venture Agreement
- Forestry Right

plus, the following documents arising from these -

- A registered Encumbrance over each Forestry Right
- Deed of Custodianship

Joint Venture Agreement

Overview

The *Joint Venture Agreement* is the agreement that sets out the contractual terms and conditions of the joint venture as agreed between the joint venture parties in respect of their mature trees for collective harvest. The parties to the Agreement are each MIS plus Forest Enterprises Limited as the manager.

Specific Terms of the Joint Venture Agreement

The following are the specific key terms (in addition to other usual terms of a joint venture) included to reflect the details of the unique collective harvest arrangement -

1. Each MIS is required to grant themselves a forestry right (further details under the heading *Forestry Right* on page 8) and to allow an encumbrance to be registered against their forestry right in favour of the other MIS in the joint venture (further details under the heading *Documents arising from Joint Venture* on page 9).
2. The MIS appoints Forest Enterprises Limited as manager to implement and manage the collective harvest on behalf of the MIS.

The joint venture agreement also -

1. Sets out the percentage share each MIS will receive of the net harvest proceeds arising from the collective harvest
2. Sets out the equitable treatment of any relevant harvesting undertaken by any of the MIS preceding the commencement date of the joint venture
3. Agrees that the joint venture will conclude when the last merchantable logs from the collective harvest have been harvested (and the resulting funds distributed to the participant MIS)

Forestry Right

Overview

As set out under the heading *Joint Venture Agreement* on page 8, each MIS agrees to grant themselves a forestry right. A forestry right is a legal instrument which separates the ownership of trees growing on an area of land from the land itself.

Using a forestry right each MIS separates the mature trees they are contributing to the collective harvest under the joint venture, from the land. Doing so then enables each MIS to meet its further obligations under the joint venture to -

- Register an encumbrance over the forestry right to secure the interests of the other MIS in the trees under the collective harvest (refer to heading *Documents arising from Joint Venture* on page 9 for further details)
- To separately deal with their land as set out under the heading *Collateral Consequences of Collective Harvest* on page 11



There are two parties to a forestry right -

1. Grantor - who is the land-owner, and
2. Grantee - party being granted rights over the trees

Initially these two parties are both the MIS itself, however for the reasons set out under the heading *Collateral Consequences of Collective Harvest* on page 11, each MIS's land is transferred to a new land-owner (new limited partnership). The terms of the forestry right therefore reflect what is necessary to protect the rights of each party as different persons.

Specific Terms of the Forestry Right

The following are the specific terms (in addition to the usual terms of a forestry right) included to reflect the details of the unique collective harvest arrangement -

1. No payment to the Grantor (land-owner) for the forestry right (ownership of the trees). Payment is not necessary because the MIS is granting itself the forestry right in respect of mature trees for which the MIS has paid all the costs over the years arising from ownership of both the land and trees.
2. An annual rental not being paid by the Grantee for the use of the Grantors land under the trees until harvested, because the land remains owned by the MIS (but indirectly as a limited partner in a new limited partnership discussed under the heading *Collateral Consequences of Collective Harvest* on page 11).

Documents arising from Joint Venture

Registered Encumbrance over Forestry Right

A forestry right is an interest in land as that term is defined in the Land Transfer Act 1952. Consequently, an encumbrance can be taken over a forestry right and registered against the land title(s). The joint venture agreement requires each MIS to register an encumbrance to secure the financial interest of the other MIS in the trees being contracted to the collective harvest under the joint venture.

Deed of Custodianship

The joint venture deals with scheme property (the trees) as that term is defined in the FMC Act. The FMC Act requires the Supervisor to hold scheme property, therefore the Supervisor of each MIS (Trustees Executors Limited) or its subsidiary company (TEA Custodians (Forest Enterprises) Limited) is the contracting party in the Joint Venture Agreement as custodian on behalf of the MIS.

The Supervisor is therefore the contracting party in the Forestry Right as custodian on behalf of the MIS as the Grantee (party becoming the owner of the trees) and as Grantor (the land-owner).

A Deed of Custodianship is therefore entered into by the participant MIS and the Supervisor which expresses the terms of the custodianship by the Supervisor consistent with the FMC Act and the MIS's governing documents.



Implementation of the Joint Venture

Overview

As discussed under the heading *Forest Enterprises' Responsibility to Act* on page 5, Forest Enterprises has a responsibility to act to address the challenges arising from the upcoming harvest of the 50 MIS under management. The solution the company has formulated is collective harvest by joint venture. The authority and process for implementation of the solution is derived from the FMC Act and the MIS's governing documents plus Statement of Investment Policy and Objectives (SIPO).

Manager's Authority to Act

The power of the manager expressed under clause 24.1(h) of the *Deed of Scheme Management* include the power to enter into any joint venture arrangement or grant rights to any property of the limited partnership which is consistent with the Plan and the objects of the limited partnership and which will directly or indirectly benefit the LP. The current Plan anticipates the harvest of each MIS's trees by the MIS and not by collective harvest. The manager therefore cannot act until *the Plan is varied in accordance with the Limited Partnership Agreement*.

Variation of the Plan

Implementation requires a variation of the Plan for planting, tending, maintaining, managing, harvesting trees on the land and carrying away any forest produce.

The variation process has two elements -

1. A compulsory element - obtaining an opinion in writing from the Forestry Auditor that the variation may be reasonably regarded as being to the commercial advantage of the limited partnership (MIS) or reasonably necessary or desirable to protect the interests of the limited partnership.
2. A conditional element - a special resolution of shareholders if such a variation would increase to any material extent the likely contributions to be made by the limited partners (Investors) above the projected capital contributions (calls paid) set out in the prospectus.

Opinion from the Forest Auditor

The Forest Auditor (Forme Consulting Group Limited) is therefore requested to review the collective harvest by joint venture and confirm or not that in their opinion this solution formulated by Forest Enterprises to the harvest related challenges identified is either or both *to the commercial advantage of the limited partnership (MIS) or reasonably necessary or desirable to protect the interests of the limited partnership*.

A copy of the Forestry Auditor's opinion is available to Investors.

Special Resolution of Shareholders (Investors)

Technically the Plan variation does not require approval as it will *not increase the contributions to be made by Investors* as the objectives of collective harvest by joint venture are to *increase revenue and reduce the risk*.

Given collective harvest by joint venture is a unique and innovative solution, a vote on the variation to the Plan is incorporated into the one Investor vote for or against implementation. The resolution voted on is a special resolution requiring a 75% majority.

Tax Considerations

Forest Enterprises has together with its professional advisors conducted extensive research and consideration of tax issues. Forest Enterprises has concluded that there are no impediments in the Income Tax Act 2007 to the joint venture proposal. Support for this opinion can be found in the reasoning set out in the binding tax ruling obtained by the participants in the Emerald Hills Collective Joint Harvest.



Joint Venture a Managed Investment Scheme

The joint venture meets the FMC Act definition of a managed investment scheme. Fortunately, there are provisions in the FMC Act which recognise that in the circumstances of use of the joint venture, the resulting MIS does not have to be registered under the FMC Act as a regulated MIS (as are the participant MIS), and the disclosure for a new regulated MIS completed.

Collateral Consequences of Collective Harvest

There are collateral consequences of collective harvest by joint venture. These consequences fall into two categories -

1. Impact on each MIS's Second Rotation Crop
2. Impact on Certain Costs and Revenue for each MIS

Impact on each MIS's Second Rotation Crop

When and where harvesting occurs determines when and where the next rotation of trees can be planted, therefore when and where the second rotation harvest can eventually occur.

Collective harvest as a joint venture has no regard to each MIS's forest boundaries, as a result an MIS could have all their land planted early or late, or potentially large and small areas of early and late plantings which may not even be over consecutive years.

Consequently, individual MIS end up with sub-optimal age class mixes (and areas of age classes), plus materially different age classes between MIS. These factors would have a material impact on the value of each MIS's land and second rotation trees, and the impact will not be consistent across each MIS in each joint venture.

Impact on Certain Costs and Revenue for each MIS

When and where harvesting and subsequent replanting occurs also determines the quantum of certain costs and revenues, plus their timing, on each MIS including -

- Replanting - will occur at different times for different area sizes for each MIS
- Forest insurance - mature trees cost more to insure than replanted trees
- Carbon lease income - stops when trees are harvested which will be at different times for different MIS

These cost and revenue impacts will not be consistent across each MIS in each joint venture.

Solution is Aggregating the Land of the MISs

Overview and Outcome of Solution

The solution Forest Enterprises has devised to the collateral consequences of collective harvest by joint venture is the transfer of each MIS's land to a new limited partnership prior to the completion of the collective harvest, plus some specific obligations in the forestry right agreement on the Grantor (the land-owner).

For reference purposes in this Report, the new limited partnership is called Land LP. Each joint venture group has its own Land LP. The limited partners in Land LP are the MIS themselves, not the Investors. This is consistent with Land LP being a land holding entity for the group of MIS.

The collective land ownership by Land LP, together with the specific forestry right obligations on the land-owner, means that the responsibility and payment obligation fall on Land LP for replanting, forest insurance and also rates.



It also means that -

- The carbon lease income becomes a revenue stream of Land LP, as does the management of the obligations under the carbon leases
- The resource consents are the obligation and cost of Land LP, as is the management of the obligations arising from these consents
- Any increase in land value is to the benefit of Land LP

This shift in responsibility and payment obligation to Land LP completely addresses the consequences which would otherwise have arisen to varying degrees as inequitable positive and negatives on each MIS in the joint venture.

Impact of Solution on each MIS

The Land LP solution ensures that each MIS is put in an equitable position relative to the other MIS in the joint venture. This is because each MIS is better off with a percentage share of the responsibility and payment obligations arising from ownership of shares in Land LP, rather than 100% share of the responsibility and payment obligations arising from continuing to own their land.

As this solution results in each MIS forgoing ownership of its land for shares in Land LP, agreement on the allocation of the shares in Land LP to each MIS is an important component of the solution.

Calculation of Each MIS's Equitable Allocation of Shares in Land LP

Overview of Land LP Share Calculation

The methodology that is chosen to allocate shares in Land LP to each MIS must result in an equitable allocation reflecting each MIS's contribution to Land LP. The number of shares allocated is both -

1. A proxy for each MIS owning their own land
2. A responsibility and payment obligation sharing mechanism for the costs of land ownership including replanting, forest insurance, rates etc
3. A responsibility and revenue sharing mechanism for the carbon leases

As a proxy for continuing to own their own land, each MIS is interested to ensure they receive an equitable share of any increase in value of all the land to be held by Land LP.

As a responsibility and payment obligation/revenue sharing mechanism, each MIS is interested to ensure it pays a fair share of the land ownership costs and receive a fair share of the carbon lease revenue.

One methodology considered for allocation of shares in Land LP was to use the same percentages calculated for share of collective harvest. This was discounted because the Forest Crop Value Methodology used for collective harvest shares reflects all variables relevant to the current crop and its harvest, however the allocation calculation for Land LP must accommodate different variables generally, and specifically in each MIS, including -

1. The emissions trading scheme land classification as Pre-1990 and Post-1989 and the consequential major difference in the treatment of the carbon sequestration asset - Post-1989 Land has a carbon asset during the rotation whereas Pre-1990 land does not.
2. Significantly reduced harvest infrastructure costs arising from re-using the infrastructure built and paid for by the first rotation which increases the net stumpage as a percentage of total sales revenue balanced against higher maintenance costs arising from maintaining the infrastructure which are a drag on the investment return.
3. Higher crop yields due to improved genetics which increases the net stumpage as a percentage of total sales revenue, plus starting net stocked areas and crop yields without the impacts of the unique events during the first rotation that impacted upon these areas now being harvested, e.g. any wind, fire and disease events.
4. Sensible age class locations relative to the built infrastructure and ability to harvest sequentially at a selected age, which increases harvest volume and therefore stumpage as a percentage of total sales revenue.



From a first principles perspective, the contributed asset by each MIS to Land LP is their cutover land and the infrastructure built on that land during harvest. This perspective suggests that the current value of each MIS's cutover land and infrastructure is the value contributed and therefore should be the input into the following formula to determine the percentage shares allocated in Land LP to each MIS -

**Percentage Shares = The percentage of each MIS current land value to the total
of the current land values for all MISs in Land LP**

Although the inputs are different, the calculation principle in this formula is the same as for the collective harvest share calculation. The worked example under the heading on page 6 therefore demonstrates the same calculation approach.

The relevance of current land value is reinforced by the knowledge that generally current value of cutover forestry land reflects the following -

- Location relative to market
- Distance in forest to public road
- Terrain -
 - Percentage hauler and ground-based harvesting, and
 - District Scheme classifications relating to erosion susceptibility
- Climate Change Response Act 2002 land classification as either Pre-1990 Forest Land or Post-1989 Forest Land
- Site index (300 Index) as a measure of forest crop quality and quantity
- Aspect relative to the sun and prevailing wind

Reporting Land LP Share Allocations to Investors

Forest Enterprises reports to Investors the input values provided by Mark Morice and the resulting share allocations arising from the formula.

Other Important Elements of Land LP Solution

Exclusion of Trees Not Part of Collective Harvest by Joint Venture

The Land LP solution addresses the collateral consequences arising from the collective harvest by joint venture of each MISs mature trees. Where an MIS has areas of forest not included in the collective harvest, these areas are removed from ownership by Land LP by a separate forestry right held by the MIS.

The terms of this forestry right are materially different to the forestry right over the collective harvest areas as the purpose is different.

The terms reflect the purpose which is to secure the MISs ownership of these trees until the end of the collective harvest by joint venture and the planned winding up of both the MISs and Land LP. This is discussed under the heading *Land LP exists prior to the Completion of Harvest* on page 14.

Land LP Calls and Tax

The funding of Land LP to meet its costs is by way of Calls on the limited partners who are the MIS participants. These Calls are budgeted by each MIS and funded from the MIS's share of the collective harvest by the joint venture. The practical effect of these Calls on Investors is therefore the same as would have occurred without collective harvest and Land LP and each MIS having to fund the costs direct from their harvest proceeds.

As Land LP is a limited partnership, the tax consequences pass through to the limited partners (the MIS), then from the MIS to the Investors. Again, the practical effect of the tax consequences on Investors is the same as would have occurred without collective harvest and Land LP.



Forest Enterprises Fee for Establishment and Operation of Land LP

Forest Enterprises does not charge a further fee for the establishment and operation of Land LP. Forest Enterprises costs are recovered from -

- The fees discussed under the heading *Value Added by Forest Enterprises and Fees* on page 7.
- The standard per hectare fee (\$28 per hectare at the date of this Report) charged each MIS.

Land LP exists prior to the Completion of Harvest

Land LP is the solution devised to address the collateral consequences of collective harvest by joint venture. Consistent with this purpose, and also consistent with the expectation in each MIS's Prospectus that the investment concludes at the end of harvest, the limited partnership agreement for Land LP expressly sets as the default that the land owned by Land LP will be sold following the conclusion of the joint venture.

The land sale will include the replanted second rotation forest on the land. The land sale will also include sale of the separate forestry rights for the trees not part of the collective harvest discussed under the heading *Exclusion of Trees Not Part of Collective Harvest by Joint Venture* on page 13.

On sale of Land LP's land, the following occurs -

1. The net sale proceeds are distributed to the limited partners (the MISs)
2. The net sale proceeds from the separate forestry rights sold with the land are distributed to the Grantee (the specific MIS which owns the trees)
3. Land LP is wound up
4. Each MIS distributes the net funds received from Land LP from the land sale to the MIS Investors as the last distribution (all funds from collective harvest having already been distributed)
5. Each MIS is wound up

This sequence of events results in each MIS being wound up at the end of harvest consistent with the expectation set in the original Prospectus for investment in each MIS.

Opportunity Preserved for Second Rotation Investment

Although the default requirement in Land LP's limited partnership agreement is for its land to be sold, the separate existence and structure of Land LP preserves the opportunity for a second rotation investment. This option is available because -

1. Land LP is a limited partnership which is the legal entity currently used by Forest Enterprises for investments
2. The second rotation trees arising from the collective harvest areas are owned by Land LP. The other trees not included in the collective harvest owned by some MIS by separate forestry right could be sold to Land LP
3. For the same reasons that each MIS was selected for its group for collective harvest by joint venture, plus the positive consequences of the collective harvest, the land and trees owned by Land LP represent a viable second rotation forest, therefore investment

If it is the wish of Investors at the time, Land LP would be transformed into a second rotation investment as follows -

1. The documentation would be changed to the documents required for a second rotation investment
2. A second rotation investment created
3. The other trees not included in the collective harvest owned by some MIS by separate forestry right would be sold to Land LP
4. The shares in Land LP held by each MIS would be devolved to the Investors in each MIS in the same proportions as the shares they hold in the MIS, resulting in the Investors personally holding the shares in Land LP, therefore the second rotation investment
5. The existing MISs would be wound up to bring the current investments to an end



Proceeding with a second rotation investment would require a unanimous decision by the limited partners (the MISs) in the Land LP. Each MIS would have an earlier vote on the proposal, and this proposal would be voted on by Investors in each MIS by Special Resolution requiring a 75% majority. To achieve 75% plus support, the proposal would include an acceptable exit mechanism for those Investors in each MIS who wish to exit at the conclusion of the first rotation to be able to do so. Forest Enterprises has relevant recent experience with these sorts of proposals.

Legal Documents Required for Land LP

Overview of Legal Documents Required for Land LP

Land LP is the solution devised by Forest Enterprises to the collateral consequences of collective harvest by joint venture. Each joint venture group has its own Land LP which is a limited partnership. The legal documents therefore comprise the -

- Limited Partnership Documents
- MIS Land Sale and Purchase Agreement
- Documents arising from Land LP and Sale & Purchase

Limited Partnership Documents

Overview

Land LP is a limited partnership, the same investment structure as each participant MIS. A limited partnership comprises limited partners and one or more general partner. The MIS in the joint venture group are Land LP's limited partners and also the shareholders of the one general partner which is a company (Land GP Limited). This structure parallels the structure of each participant MIS, including the appointment of Forest Enterprises Limited Directors as the directors of Land GP Limited.

Land LP Limited Partnership Agreement

Land LP exists exclusively for the benefit of the limited partners (the MISs) as the owner of their land and consequentially responsible for paying certain costs, receiving any carbon lease revenue, and managing certain land-owner and related obligations (e.g. resource consents).

The *Limited Partnership Agreement* therefore expresses this purpose, plus the powers and responsibilities related to the consequential land ownership outcomes.

A key clause in the *Limited Partnership Agreement* is the requirement that the land owned by Land LP must be sold at the end of the joint venture UNLESS the limited partners (the MIS) vote unanimously otherwise. This is a key element underlying the rationale for Land LP set out under the heading *Solution is Aggregating the Land of the MISs* on page 11.

The *Limited Partnership Agreement* also -

1. Prescribes that the MIS limited partners vote according to the majority vote of the Investors in their MIS decided by a prior vote by these Investors. This means that the majority view of the underlying Investors in each MIS determines the outcome of a vote by the Land LP limited partners. Voting on any statutory or procedural matters does not require a prior vote by Investors.
2. Appoints Forest Enterprises Limited to manage Land LP (and for the company's directors to be the directors of the Land LP) as an extension of the company's responsibilities as manager of the MISs.



Land GP Limited Constitution

Land GP Limited exists exclusively to be the general partner of Land LP therefore its *Constitution* expresses this purpose and the resulting requirements as Land LPs general partner.

A key clause is the appointment of the Forest Enterprises Limited directors as the directors of Land GP Limited, consistent with their current similar appointment as directors of each participant MIS general partner company.

The *Constitution* also prescribes the same voting system for MIS shareholder votes as prescribed for MIS limited partners votes.

MIS Land Sale and Purchase Agreements

Each MIS completes a *Land Sale and Purchase Agreement* to sell their land to Land LP. The sale is subject to any *Forestry Rights* required to exclude trees which are not part of the collective harvest by joint venture, discussed under the heading *Exclusion of Trees Not Part of Collective Harvest by Joint Venture* on page 13.

The *Land Sale and Purchase Agreement* also specifically agrees (acknowledges) -

1. That the consideration for the sale is allocation of the agreed shares in Land LP. For further details refer to the heading *Calculation of Each MIS's Equitable Allocation of Shares in Land LP* on page 12.
2. That -
 - a. Similar *Land Sale and Purchase Agreements* are being entered into by the other named participant MIS.
 - b. The named MIS have entered into a Joint Venture Agreement for collective harvest of the trees secured by the listed *Forestry Rights* secured by the listed *Encumbrances*.
3. That Land LP (the Purchaser) will grant a *Right of Way* over the title(s) in the *Land Sale and Purchase Agreement*, and also the titles in the similar *Land Sale and Purchase Agreements* being entered into by the other named participant MIS. The *Right of Way* is to facilitate access to undertake the collective harvest expressed in the *Joint Venture Agreement* and in each *Forestry Right* pursuant to the *Joint Venture Agreement*.
4. That any existing encumbrance granted in favour of Trustees Executors Limited will be removed from the title(s) on or before settlement. Those MIS which own their land directly have an encumbrance registered on the title(s) in favour of Trustees Executors Limited. This encumbrance means that any land dealings require the consent of Trustees Executors Limited, a similar investment protection outcome to direct custodianship. These encumbrances are no longer required as Trustees Executors Limited will end up holding the land as custodian for Land LP rendering any existing encumbrances redundant.

Documents Arising from Land LP and Sale & Purchase

Forestry Rights

A *Forestry Right* is required if the *Land Sale and Purchase Agreement* specifically refers to the requirement for a *Forestry Right* to exclude trees which are not part of the collective harvest by joint venture.

The *Forestry Right* includes the following specific terms (in addition to the usual terms of a forestry right) to reflect the unique purpose for the *Forestry Right* in the context of Land LP -

1. No payment to the Grantor (land-owner) for the forestry right (ownership of the trees) because the MIS is granting itself the forestry right in respect of trees for which the MIS has paid all the costs over the years arising from ownership of both the land and trees.
2. An annual rental not being paid by the Grantee for the use of the Grantors land under the trees because the land remains owned by the MIS as a limited partner of Land LP.
3. The rates being paid by the Grantee (the MIS) equal to the expressed proportion of the land area under the *Forestry Right* to the total land area. This formula is worded so that it correctly carries through to the calculation when the land area becomes part of the total land area which transfers to Land LP from all the participant MISs.



Right of Way Agreement

The *Right of Way Agreement* implements the specific requirement expressed in the *Land Sale and Purchase Agreement* that Land LP will grant a *Right of Way* over the title(s) in the *Land Sale and Purchase Agreement*, and also the titles in the similar *Land Sale and Purchase Agreements* entered into by the other named participant MIS. The *Right of Way* is to facilitate access to undertake the collective harvest expressed in the *Joint Venture Agreement* and in each *Forestry Right* pursuant to the *Joint Venture Agreement*.

Agreement with Carbon Lease Company

Some of the MISs have carbon lease agreements with New Zealand Carbon Leasing (No. 1) Limited. The transfer of the land to Land LP requires the consent of the lessee, New Zealand Carbon Leasing (No. 1) Limited. The terms of this consent are expressed in this agreement, including the consequential outcome that the obligations of the multiple carbon leases for the multiple MISs will be managed as one by Land LP.

Deed of Custodianship

The land transfers to Land LP (and any forestry rights) deal with scheme property as that term is defined in the FMC Act. The FMC Act requires the Supervisor to hold scheme property, therefore the Supervisor of each MIS (Trustees Executors Limited) is the contracting party as custodian on behalf of each MIS.

The Supervisor is also the contracting party as custodian in respect of the *Right of Way Agreement* and the *Agreement with Carbon Lease Company*.

A Deed of Custodianship is entered into by the participant MIS and the Supervisor which expresses the terms of the custodianship by the Supervisor consistent with the FMC Act and the MIS's governing documents.

Implementation of Land LP

Overview

As discussed under the heading *Forest Enterprises' Responsibility to Act* on page 5, Forest Enterprises has a responsibility to act to address the challenges arising from the upcoming harvest of the MIS under management. The solution the company has formulated is collective harvest by joint venture which solution requires transfer of the land to Land LP to address the collateral consequences of collective harvest by joint venture.

The authority and process for implementation of the Land LP element of the solution is derived from the FMC Act and the MIS's governing documents plus Statement of Investment Policy and Objectives (SIPO).

Disposal of a Primary Asset

The transfer of the land to Land LP is a form of disposal of a Primary Asset. The SIPO for each MIS (referred to on page 5) addresses the requirements in respect of disposal of assets.

Manager's Authority to Act

The manager's authority to implement Land LP and arrange for the transfer of the land to Land LP therefore requires a Special Resolution of Investors as limited partners in their MIS. This special resolution is in addition to the Special Resolution the manager (with the agreement of the Supervisor) considers is required to approve the Plan Change necessary for proceeding with the collective harvest by joint venture (refer to heading *Special Resolution of Shareholders (Investors)* on page 10 for further details).



Decision by Investors in Each MIS

Implementation of the collective harvest by joint venture is dependent upon passing of both Special Resolutions -

1. Approving the Plan Change
2. Approving the Disposal of the Land

The two resolutions are therefore combined into one omnibus resolution, one Investor Vote, For or Against collective harvest by joint venture. This omnibus resolution also incorporates all related elements consequential to collective harvest by joint venture and use of Land LP.

Land LP a Managed Investment Scheme

The use of Land LP by the participant MIS to address the collateral consequences of collective harvest by joint venture meets the FMC Act definition of a managed investment scheme. Land LP itself is therefore a managed investment scheme. Fortunately, there are provisions in the FMC Act which recognise that in the circumstances of use of Land LP, the Land LP MIS does not have to be registered under the FMC Act as a regulated MIS (as are the participant MIS), and the disclosure for a new regulated MIS completed.

