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Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

(e) economics.sen@aph.gov.au

Submission — Senate Standing Committee on Economics
Inquiry into Forestry Managed Investment Schemes

The Australian Forest Products Association (AFPA) welcomes the opportunity to provide input into the Inquiry into Forestry Managed Investment Schemes (MIS). Please find the AFPA submission attached.

AFPA is the peak national body for Australia's forest, wood and paper products industry. We represent the industry's interests to governments, the general public and other stakeholders on matters relating to the sustainable development and use of Australia's forest, wood and paper products. Forest industries support around 200,000 direct and indirect jobs nationally with a gross value of turnover of around $22 billion.

AFPA and its predecessors (the National Association of Forest Industries and the Australian Plantation Products and Paper Industry Council) have a long history of stakeholder engagement on forestry MIS, the plantation taxation arrangement and financial services arrangements supporting plantation investment through the numerous reviews undertaken by Senate and House of Representative Committees and Federal Government departments over the past decade.

AFPA notes the broad terms of reference for the inquiry, but do not consider that we can comment effectively on some of the subject matter. The attached submission focuses only on the policy and regulatory issues around the MIS structure and plantation taxation arrangement.

AFPA recognises the adverse impacts the unintended collapse of many forestry MIS companies had on many investors at the onset of the GFC, and is committed to working constructively with Governments, the industry and the finance sector to improve the financial due diligence and operation of the forestry MIS structure in combination with the plantation taxation arrangement. In addition to the damaging and disruptive effects the collapse of many forestry MIS companies had on investors, these impacts were also felt across the broader plantation forest products industry.

It is acknowledged that there have been concerns about past practices of MIS companies and financial advisers marketing MIS products. However, as discussed in further detail in this submission, there have been several reviews and inquiries into these practices over the past decade that have resulted in changes to the Corporations Act (through the Future of Financial Advice Reforms), Australian Securities and Investment Commission disclosure requirements and new plantation taxation arrangements that strengthen the MIS structure and enhance financial safeguards to protect investors.

Therefore, subject to appropriate standards of due diligence and corporate governance, the MIS structure and plantation taxation arrangement should continue to be available to support new plantation investment. This is consistent with the view of the financial services regulator, the Australian Securities and Investment Commission (ASIC). For similar reasons as those set out in this submission, the ASIC submission to this Inquiry notes that in their view the current regulatory arrangements for managed investment schemes are adequate (submission 34 p. 49).

The key point that AFPA would like to make is that the MIS structure, in combination with the plantation taxation arrangement, has had some success in attracting private investment for new plantation establishment. This contrasts with the experience in most other countries, which have not been successful in attracting private investment for new plantations without well-funded public subsidy programs or taxation measures.

Through the establishment of plantation resources we can continue to build Australia's future, providing sustainable timber for homes and sustainable pulp for paper making. These plantations are also capturing carbon to offset emissions from other sources and provide a range of other environmental benefits. This represents a highly sustainable and productive use of the land on which the plantation resource is established. Why import wood and paper products to meet the needs of our communities when we can grow and produce these products more sustainably and proficiently at home?

It is important to understand that the plantation taxation arrangement does not come at a cost to the tax payer, which is a fact often overlooked or misunderstood by the community. Indeed, overall the plantation taxation arrangement delivers net tax revenue to the government. The main benefit of the plantation taxation arrangement is that the investor is able to bring forward the tax deductibility of their investment in the establishment and maintenance of the tree plantation. However, this is offset by the forestry MIS companies paying tax on all investor funds received at the time of the investment and the (substantial) tax paid by the investor on the full sale price of wood products at the time the plantation is harvested (typically 10 to 12 years after the initial investment for fast grown hardwood plantations and longer for softwood).

AFPA would also like it noted that the MIS structure and plantation taxation arrangement has been extensively reviewed over the past decade, resulting in new plantation taxation arrangements (i.e. a specific carve out – *Division 394* of the *Income Tax Assessment Act 1997)*, changes to the *Corporations Act* (through the *Future of Financial Advice Reforms*) and new ASIC disclosure requirements. These changes address many of the concerns about past practices of forestry MIS companies and financial advisers marketing forestry MIS products, by strengthening MIS structure and enhancing financial safeguards to protect investors. With very limited investment in forestry MIS since the global financial crisis (2008), these reforms remain largely untested.

These reviews and the subsequent regulatory reforms that improved the integrity of the forestry MIS structure and plantation taxation arrangement. Since 2010, after the impacts from the GFC had subsided, no failures or insolvencies of MIS companies have occurred. Given this, the MIS structure and taxation arrangement should continue to be available to support new plantation investment consistent with the new regulatory changes to improve corporate accountability and financial due-diligence. Further to this, taking into account the public good benefits associated with plantation establishment, the government should make some effort to restore confidence and stimulate further investment in the sector.

There has been much debate around the benefits and costs of forestry MIS and the plantation taxation arrangement. However, it should not be overlooked that it has created a substantial regionally located plantation estate that will be harvested and replanted over the decades to come. Not only will these plantations continue to deliver a long term secure supply of resource for the forest products industry, but also provide long-term, secure jobs in regional communities and strengthen and diversify regional economies.

Further expansion of the plantation resource is needed to support future investment in processing and boost the competitiveness of the industry. The costs of not expanding the plantation resource are many and will be broadly felt across the Australian economy and regional communities. They include the risk of a decline in the forest industry over the longer term, as existing production facilities will not be able to expand to remain competitive and profitable in an increasingly global economy. As the forest industry is regionally based, this will result in shrinking job opportunities in rural communities and further decline in regional economies. It will also lead to shrinking forest product exports, currently valued at over $2 billion per year, and an increasing reliance on imports of forest products. These wood product imports are likely to be sourced from countries with less sustainable forest management systems than Australia, increasing the risk of supporting illegal logging. With more limited availability of wood products in Australia, there is also likely to be a greater reliance on alternative materials in construction, such as steel, aluminium and plastics that have greater embodied energy and a larger environmental footprint. It also represents a missed opportunity to produce low cost, efficient carbon emissions offsets. Without the carbon sequestration and storage provided by an expanding plantation resource, Australia will be left to rely on a reduced number of options (that are potentially more costly and less efficient) to reduce its carbon emissions and meet future net carbon emissions targets.

For any queries or further clarification of the issues raised in this submission please contact Peter Grist on (02) 6285 3833 or peter.grist@ausfpa.com.au.

Yours sincerely

Ross Hampton
Chief Executive Officer

AUSTRALIAN FOREST PRODUCTS ASSOCIATION

trees wood paper

Senate Standing Committee on Economics Inquiry into Forestry Managed Investment Schemes

The Managed Investment Schemes Structure

Managed Investment Schemes (MIS) are common financial instruments that are not unique to forestry activities. The MIS structure is used for a wide range of investment options in Australia including:

- Listed real property and infrastructure schemes
- Unlisted property trusts and syndicates, and mortgage funds
- Cash, bonds, equity and multi-sector managed funds
- Time-share, horse-breeding or racing, services strata and film schemes
- Agribusiness and forestry

The MIS structure enables a large number of investors (either retail or wholesale) to pool funds, or invest in a common enterprise, for large-scale projects. Some MISs are principally investment vehicles, while others are enterprises in their own right.

The Act regulating MIS was introduced on 1 July 1998 (*Managed Investments Act 1998*) and subsequently incorporated into Chapter 5C of the *Corporations Act 2001*. However the structure existed for many decades prior to the Act as 'prescribed interest' regimes. Forestry companies have been using the MIS structure for investments in forestry projects since the 1970s.

Key legislative requirements of MISs are that investors funds are pooled for a common purpose, but the investors do not have day-to-day control of the operation of the enterprise, with the scheme managed day-to-day by a 'responsible entity'. Enterprises often operate under a combined MIS/corporate structure, where the company takes an active role in operating the enterprise, while the property of the enterprise is held passively through the MIS structure.

Various types of MISs constitute around 8% of the total market capitalisation of securities listed on the ASX market (around $116 billion in 2010). Around 80% of commercial real estate (office buildings, shopping centres and industrial facilities) are held in MISs. Most major infrastructure projects, including those using the public private partnerships model, utilise MIS. Overall, even at their peak during the early- to mid-2000s, forestry projects represented less than 4% of the value of the MIS sector operating in Australia.

Forestry Plantation Investment

The inherent characteristics of forestry plantations create significant challenges in attracting private investment due to the large scale required to achieve a viable resource, relative illiquidity of the asset, high initial costs and long waiting period for a return.

This puts forestry plantations at a significant disadvantage relative to many other investment options that can provide annual, shorter and/or more regular returns on investment.

In addition to their commercial wood value, plantations provide a range of environmental and social benefits, such as carbon sequestration, soil and water conservation, rehabilitation of degraded landscapes and recreational opportunities, that cannot be captured in the market system by a private investor.

As a result of these challenges in attracting private investment and the public good benefits that cannot be monetised, there is significant under-investment in new plantation development.

Forestry Managed Investment Schemes

Notwithstanding the issues surrounding the collapse of many MIS companies following the onset of the GFC, the MIS structure has proven successful in leveraging private sector investment in plantation development. This was because it addressed the characteristics that limit private investment in plantations, by:

- providing investment scale through pooling of investment funds
- providing economies of scale through year-on-year investment in the resource
- addressing information deficiencies and lowering transaction costs
- Improved cash flow to help offset high up-front establishment costs

For forestry projects, MIS investments are structured so that the investor is recognised as ‘carrying on a business’ for tax purposes, thereby able to claim a tax deductions for costs associated with the normal operations of their business. This aligns with the standard taxation treatment of an individual or company involved in agribusiness or any other business activities. For forestry projects, normal operations include activities associated with plantation establishment such as site preparation, planting and maintaining the trees. However, capital costs, such as land, are not deductable and capital gains on any appreciation in the value of the land are applicable following the sale of these assets. With land not a tax deductible expense, to support their forestry MIS projects, many MIS companies purchased land and leased it to investors.

Prior to 2007, the Australian Tax Office (ATO) approved the arrangement that recognises forestry MIS investors as 'carrying on a business' through the issue of product rulings for individual project. This arrangement was made formal following the 2005-06 Plantation Taxation Review, through the *Tax Laws Amendment (2007 Measures No. 3) Act 2007,* which became *Division 394* of the *Income Tax Assessment Act 1997* (also known as the Plantation Taxation Arrangement).

For agribusiness MIS arrangements, the Australian Taxation Office funded a test-case in 2008 (Hance & Hannebery v FC of T – FCAFC 196) to ascertain the 'carrying-on a business' status and tax deductibility of investments. In this test-case, the Full Federal Court found that expenses of an agribusiness MIS were not capital in nature and were allowable deductions incurred in carrying-on a business. The decision applied to all investors in agribusiness MIS, including forestry MIS, where the schemes were structured for investors as 'carrying on a business'.

Plantation Policy Drivers

Plantation policy over the past 20 years has been driven by the *National Forest Policy Statement 1992* (NFPS) and the *Plantations for Australia: the 2020 Vision 1997* (Plantations 2020 Vision).

While the NFPS focused mainly on sustainable native forest management, a key goal of the NFPS was to 'expand Australia's commercial plantations of softwood and hardwoods so as to provide an additional, economically reliable and high-quality wood resource for industry'.

The Plantations 2020 Vision was introduced to support the plantation expansion goal of the NFPS. The overarching principle of the Plantations 2020 Vision strategy is to 'enhance regional wealth creation and international competitiveness through a sustainable increase in Australia's plantation resources', based on the national target of trebling the area of commercial tree crops by 2020, from around 1 million hectares at that time, to 3 million hectares. It included sixteen actions to promote the development of appropriate structures that would encourage investment in the plantation sector. These were broadly grouped under five strategic themes:

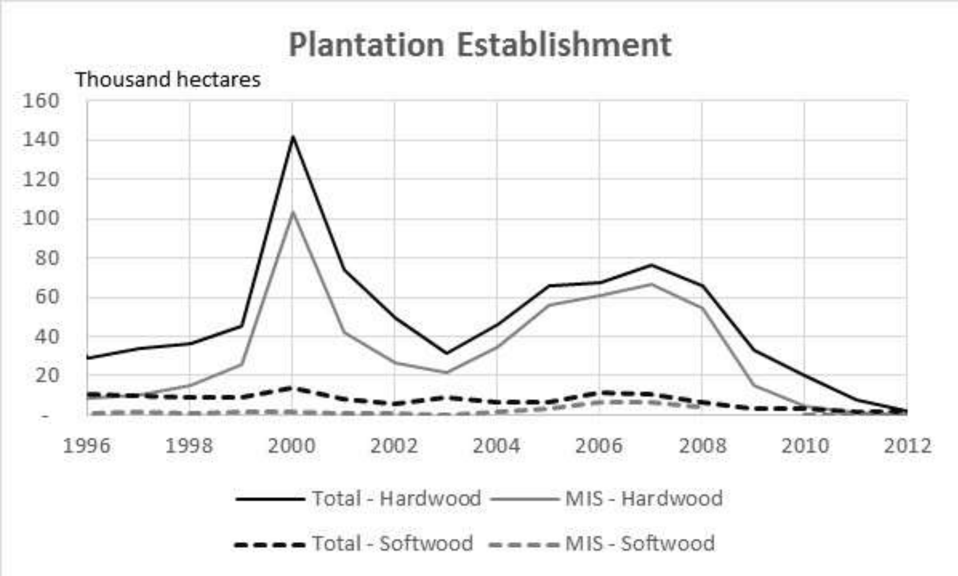
- the policy framework
- the regulatory framework
- investment growth
- social and environmental factors
- monitoring and review

Following the release of the Plantations 2020 Vision, the MIS structure and treatment of investors as 'carrying-on a business' for tax purposes was promoted by both government and industry to attract private investment in plantation expansion. However, it should be noted that the use of MIS or similar structures and the 'carrying on a business' taxation treatment for plantation investors had been used to support plantation investment (on a smaller scale) since the 1970s.

Other supporting policies introduced as part of the Plantations 2020 Vision included *profit à prendre*, which enabled the separation of ownership rights to the trees from the ownership of the land. As land use is legislated at the state level, all states have adopted changes to legislation that facilitate *profit à prendre* in some form.

Supported by the Plantations 2020 Vision, the plantation resource expanded at a rate of around 70,000 ha per year between 1998 and 2008, and Australia was in line to meet the Plantation 2020 target (Figure 1). Over this period, around two thirds (540,000 ha of a total of almost 800,000 ha) were established by MIS companies.

Figure 1: Annual plantation establishment between 1996 and 2012.



Proposed Investments to Utilise the Plantation Resource

The plantations established by MIS companies are strategically located in eight main regional hubs – Albany and Bunbury in WA, Northern Tasmania, Green Triangle on the SA-Victoria border, Gippsland in Victoria, Tumut-Tumbarumba and Eden-Bombala in NSW and the far north in the Northern Territory. They were established on the premise that they would initially rely on export woodchip markets during their development phase, but once an estate was fully established they would support the development of world-scale pulpmills and other wood processing facilities.

Through the early to mid-2000s these plantation resources were expanding on track to support the development of pulpmills. By the mid-2000s several proposals, with a total value of more than $7 billion, were put forward to utilise this resource. The proposed investments included new pulpmills at Bell Bay Tasmania (Gunns), Penola in SA or Heywood in Victoria (Protavia) and Collie in WA (Griffin Group), as well as pulpmill upgrades by Australian Paper in Maryvale Victoria, Kimberly Clarke in Millicent SA, Visy in Tumut NSW and Norske Skog pulpmills in Albury NSW and Boyer Tasmania. Other proposals included woodchip export facilities in Portland Victoria and Bunbury WA and the Lignor engineered wood facility in Albany WA.

Unfortunately, due to regulatory hurdles and the turmoil following the Global Financial Crisis, investment funds for major projects such as these dried up overnight. Therefore, very few of these proposals went ahead. As a result, the full economic benefit of many of the plantations established by many MIS companies have not been realised, with some plantations now isolated with few market opportunities and others left to rely on export woodchips markets, rather than being processed locally.

The Impact of the Global Financial Crisis on the MIS Sector

The Global Financial Crisis (GFC) caused a major disruption to international economies, and a severe shock to investor confidence in Australia. This had serious ramifications for the investment market in Australia and particularly impacted the forestry MIS companies.

To ensure land was available on a timely basis for plantation development many forestry MIS companies established large land banks and leased the land to the plantation investors. This left many MIS companies highly leveraged, due to the loans to purchase this land.

At the onset of the GFC in 2008, with the consequent collapse in business and consumer confidence, investment in forestry MIS essentially dried up. With a lack of cash flow and their highly leveraged position, the banks were quick to make a call on the MIS companies. Unable to meet the demands of the banks, many forestry MIS companies became insolvent and were forced into liquidation.

This had unfortunate flow on effects to the investors and the allied service industries (eg. nurseries, contractors involved in site preparation and tree planting, etc.), as well as the landowners that had leased, rather than sold, land to the MIS companies.

The forestry MIS sector was not alone in experiencing difficulty following the GFC. Many other investment vehicles that used the MIS structure, such as Real Estate Investment Trusts (REITs) and other unlisted property trusts, also experienced a dramatic decline in investment return. For example, the Australian Stock Exchange (ASX) has noted that some highly geared Australian REITs that were achieving strong investment returns prior to 2007, experienced losses of up to 55% in 2008[1].

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[1] http://www.asx.com.au/education/investor-update-newsletter/a-reits-back-on-course.htm

Reviews of the Taxation and MIS Arrangements

The plantation taxation arrangement and the MIS investment structure has been extensively reviewed over the past decade. There have been many changes that have emerged from these reviews, which have strengthened the MIS structure and enhanced the financial safeguards to protect investors.

The Plantation Taxation Review 2005-06 and subsequent changes to the Taxation Act in 2007 to create *Division 394* of the *Income Tax Assessment Act 1997* (the Plantation Taxation Arrangement) addressed many of the concerns surrounding forestry MIS. The legislative changes were aimed at:

- improving the transparency of the MIS arrangements
- constraining the practices of financial advisers selling the products
- improving the silviculture (the way trees were planted and managed)
- allowing greater liquidity of plantation assets through secondary market trading

The new plantation taxation arrangement also introduced a number of integrity measures. The most important of these was the requirement that at least 70% of project expenditure over the life of the project must be direct forestry expenditure (DFE), such as site preparation, tree planting, tending and harvesting, and land lease costs. This addressed concerns relating to generous commissions to financial advisers and profits returned to the operators of some MIS companies, as it specifically excludes marketing, commissions, insurance, contingencies and general business overheads.

The new arrangement also extended the maximum allowable period between the investor funds being received and the establishment of trees from 12 to 18 months. This improved silvicultural practice and ensured that tree planting occurred at the optimum time for tree survival — rather than the MIS companies being forced to plant in the wrong season (i.e. in the middle of a hot dry summer) to meet notional regulatory requirements, so that the investor could receive their tax deduction.

This was followed by the review of agribusiness MIS in 2008 which addressed structural issues related to agribusiness MIS projects and investor related issues such as financial advice and disclosure requirements. It also looked into the collapse of the two largest operators (Great Southern and Timbercorp), and post-collapse policy implications. The key recommendations emerging from the review related to:

- only allowing tax deductions for non-forestry agribusiness MIS investment to be offset against future taxable income from the same MIS

- requiring ASIC to appoint a temporary Responsible Entity when a MIS becomes externally administered or a liquidator is appointed
- requiring agribusiness MIS to disclose the qualifications and accreditation of third parties that provide expert opinion on likely scheme performance

The 2009 Parliamentary Joint Committee on Corporation and Financial Services Inquiry into financial products and services in Australia, dealt with the provision of advice across the broader financial services sector. It led to the Future of Financial Advice reforms, with changes to the *Corporations Act* in 2012 and 2014 to address conflicted advice as well as a best interest duty for financial advisors and fee disclosure arrangements.

In 2010, the Australian Securities Investment Commission (ASIC) initiated a consultation process on a proposed policy on disclosure for agribusiness MIS (Consultation Paper CP133 – A*gribusiness managed investment schemes: Improving disclosure for retail investors*). Following the consultation process, in 2012 ASIC introduced new disclosure requirements for the responsible entities of agribusiness MIS (including forestry MIS), requiring them to disclose against five benchmarks and apply five disclosure principles. These disclosure requirements aimed to ensure that retail investors are better informed about the nature of these investment and the potential risks associated with them.

Given that there has been very little investment in forestry MIS over the past five years, with confidence in the sector evaporating following the Global Financial Crisis, these changes in the plantation taxation arrangement, *Corporations Act* and ASIC disclosure requirements remain largely untested.

Industry Restructuring

The plantation forest sector has been through a substantial restructure over the past five years, with the ownership of most major forestry MIS assets purchased by institutional investors, such as superannuation funds and Timber Investment Management Organisations (TIMOs).

In 2009, around 36% of the plantation resource was owned by MIS companies, 35% by government and 13% by institutional investors (superannuation funds and Timber Investment Management Organisations [TIMOs])[2]. The remainder were held

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[2] Garvan M and Parsons M (2011) *Australian Plantation Statistics 2011*, Australian Bureau of Agriculture and Resource Economics and Science, Canberra.

mainly by timber industry companies, international pulp and paper companies and individuals with farm forestry projects. By 2013 plantation ownership had shifted, with over 50% owned by institutional investors, 18% by government and less than 5% by MIS companies. The ownership of around 7% of former MIS plantations is uncertain, as it remains in the hands of receivers.

The shift in ownership of much of the MIS plantation resource to international institutional investors with a long term investment outlook can provide long term stability to the plantation sector and lead to improved management practices. It can also drive the development of new domestic and international markets for the resource, as the new owners seek to gain the highest value from the resource.

Future of the MIS resource

The resource established through forestry MIS are working profitable assets, with harvesting being carried out for over a decade. Over this period, the volume of hardwood plantation pulplog has increased from 1.4 million cubic metres in 2002-03 to 5.4 million cubic metres in 2012-13. Consonant with the rising volume, the value of plantation hardwood pulplogs harvested has increased more than four-fold, from $81 million in 2002-03 to almost $350 million in 2012-13 (ABARES Forest and Wood Product Statistics May 2014).

The plantation assets established by MIS companies, represent a unique resource in the Asia Pacific region. With a strong regulatory regime in Australia, the legal rights to harvest and sell the resource are clear and indisputable. The management is proven to be sustainable through accreditation by either or both of the internationally recognised certification schemes for sustainable forest management (Forest Stewardship Council and/or the Program for Endorsement of Forest Certification through the Australian Forestry Standard). The trees are of preferred species (mainly *Eucalyptus globulus* and *Pinus radiata*) with high quality wood fibre. They are concentrated around a small number of key processing hubs, with a limited geographic spread, and of a scale that is capable of supporting globally competitive processing facilities.

The rising volume and value of plantation logs harvested is driving a substantial increase in regional employment and boosting regional economies, particularly in the regions of the Green Triangle, Southwest WA, southern NSW, eastern Victoria and northern Tasmania. Although much of the former MIS resource currently being harvested is exported as woodchips or peeler logs, new markets are being sought for this resource and there are signs that new industry development and investment around the resource is beginning to re-emerge.

Recent forest industry investments include the $84 million upgrade by Norske Skog Australasia to produce coated papers; $77 million sawmill upgrade by Dongwha in Bombala; $7.8 million upgrade to the Tarpeena sawmill by TimberLink in South Australia and a proposal for a bioenergy facility adjoining the site.

The success of the TaAnn peeler mills in Tasmania, which uses small diameter eucalypt regrowth, suggests that similar operations using (small diameter) plantation logs could be developed in the future. Similarly, the former Forest Enterprises Australia (FEA) sawmill in Tasmania that produced structural timber products from small diameter plantation hardwood logs using Hewsaw sawmilling technology, indicates similar opportunities to create sawn products from plantation logs could also be developed.

There has been much debate around the benefits and costs of forestry MIS and the plantation taxation arrangement. However, it should not be overlooked that it has created a substantial regionally located plantation estate that is being and will continue to be harvested and replanted over the decades to come. It will not only continue to deliver a long term secure supply of resource for the forest products to industry, but also provide long-term secure jobs in regional communities and strengthen and diversify regional economies.

Continued expansion of the plantation resource

There is a strong case for further expansion of the plantation resource to meet the resource demands of existing industry, support industry expansion and new industry development, and capitalise on the environmental benefits, particularly carbon emissions offsets.

Currently the softwood resource is fully allocated, offering little opportunity for existing industry to invest and expand. There are serious concerns in some key plantation regions, such as southeast Queensland, the Green Triangle on the Victorian – South Australian border, the Tumut-Tumbarumba and Bathurst-Oberon regions of NSW and the Gippsland region of Victoria, about the ability to meet the future resource needs of the existing industry. To maintain a viable softwood processing sector over the next fifty years, additional resource is needed in these key plantation growing regions. This will allow industry to invest, maximising the value added and increasing economies of scale, so as to remain competitive in an increasingly global market.

Although the hardwood pulpwood resource is currently contracting and focused on export markets, there is significant potential to develop domestic processing around these resources (which was the original intent). In many regions, if the resource is to support a sustainable industry, further expansion of the plantations is needed to supplement the existing estate, and provide an even flow of resource over the full rotation period.

In addition to their commercial wood value, plantations provide a number of environmental and social benefits, such as carbon sequestration and storage, water quality improvements and erosion control. However, these positive externalities are typically not captured and/or monetised in existing markets, resulting in under-investment in plantation establishment.

For example, it is widely accepted that commercial plantations offer one of the most efficient and effective approaches for large-scale reductions in carbon emissions over the long term. A plantation estate that is harvested and replanted, sequesters and stores large volumes of carbon that can offset emissions from other sources. Currently, Australia's Kyoto compliant plantations (i.e. those established post-1990 on cleared agricultural land) of approximately 800,000 ha (mostly established through forestry MIS), contribute an emission offset of around 4.5% of Australia's total annual emissions of 552 million tonnes. Yet this carbon is not given a commercial value, with commercial plantations effectively excluded from the Carbon Farming Initiative (CFI) due to the additionality criteria and the negative list, which restricts tree planting to regions with average annual rainfall below 600 mm. As a result, there has not been any methodologies developed under the CFI that enable the carbon sequestered and stored by commercial plantations to be formally recognised or traded through the Emissions Reduction Fund. This disadvantages plantations relative to other carbon emissions reduction activities and results in significant under-investment in the new plantation development.

The costs of not expanding the plantation resource are many and will be broadly felt across the Australian economy and regional communities. They include the risk of a decline in the forest industry over the longer term, as existing production facilities will not be able to expand to remain competitive and profitable in an increasingly global economy. As the forest industry is regionally based, this will result in shrinking job opportunities in rural communities and further decline in regional economies. It will also lead to shrinking forest product exports, currently valued at over $2 billion per year, and an increasing reliance on imports of forest products. These wood product imports are likely to be sourced from countries with less sustainable forest management systems than Australia, increasing the risk of supporting illegal logging. With more limited availability of wood products in Australia, there is also likely to be a greater reliance on alternative materials in construction, such as steel, aluminium and plastics that have greater embodied energy and larger environmental footprint. It also represents a missed opportunity to produce low cost, efficient carbon emissions offsets. Without the carbon sequestration and storage provided by an expanding plantation resource, Australia will be left to rely a reduced number of options (that are potentially more costly and less efficient) to reduce its carbon emissions and meet future net carbon emissions targets.

A Continuation of the MIS structure and plantation taxation arrangement

Despite several of the major forestry MIS companies folding in recent years, the MIS structure and plantation taxation arrangement, remains a viable option to attract private sector investment into plantations establishment.

Following the GFC, there is still a small number of forestry MIS companies that continue to operate. These have proven to be well managed and fiscally sound companies, and should be allowed to continue to operate and access the MIS structure and plantation taxation arrangement.

It is acknowledged that there have been concerns about past practices of MIS companies and financial advisers marketing MIS products. However, as discussed above, there have been several reviews and inquiries into these practices over the past decade that have resulted in the new plantation taxation arrangements that strengthen the MIS structure and enhance financial safeguards to protect investors, as well as the changes to the *Corporations Act* (through the Future of Financial Advice Reforms) and ASIC disclosure requirements.

Therefore, subject to appropriate standards of due diligence and corporate governance, the MIS structure and plantation taxation arrangement should continue to be available to support new plantation investment.

This is consistent with the view of the financial services regulator, the Australian Securities and Investment Commission (ASIC). For similar reasons as those set out in this submission, the ASIC submission to this Inquiry notes that in their view the current regulatory arrangements for managed investment schemes are adequate (submission 34 p. 49).

Proposed future arrangements for forestry MIS

If there are lingering concerns around the viability of the forestry MIS arrangement, then effort should be focused on addressing any outstanding issues that affect the efficacy and integrity of the arrangement, rather than closing off the MIS arrangement for forestry investors.

One issue that has been raised previously, but was not addressed by either the changes to the tax act following the Plantation Taxation Review, or Future of Financial Advice Reforms was the appropriateness of the upfront fee model used by most forestry MIS companies for projects that have a lifespan of 10 years.

While the main costs associated with a forestry MIS project are incurred in the first three years, related to plantation establishment, including forming access roads, site preparation, tree planting and clearing of competing vegetation, there are also some ongoing costs, such as lease payments for land, maintaining fire breaks and monitoring for pests and disease. Given the financial challenges faced by many major forestry MIS companies following the GFC, questions were asked as to whether forestry MIS companies maintained sufficient cash reserves to cover these ongoing costs.

To address these concerns and to remove any questions as to the ongoing viability of established forestry MIS projects, it is proposed that forestry MIS companies which accept upfront payments from retail investors to cover the whole life of a project be encouraged to maintain a reserve account, with sufficient funds held in trust to cover any ongoing costs. Alternatively, companies managing retail forestry MIS projects could be encouraged to adjust their fee model, to involve a large initial payment to cover plantation establishment, as well as a small annual payment to cover ongoing costs such as land lease payments.

The need for a reserve account or trailing annual payments is less relevant for wholesale investors, as they are likely to have a larger share of the investment in a forestry MIS project and greater influence over the management of fund in the forestry MIS project.

The adoption of the trust account or the alternative fee model for retail investors would ensure forestry MIS companies maintain sufficient funds to carry projects to their conclusion and it would remove any doubt around the ongoing financial viability of forestry MIS arrangement.

This is consistent with recommendations put forward by ASIC in their submission (Submission 34 p.51), which suggested changes to the business model to improve investor protections, including requiring schemes to have in place measures to ensure sufficient cash flow and capital are maintained within the schemes to meet its ongoing financial obligations.

Summary

AFPA is grateful for the opportunity to provide input into the Inquiry into Forestry Managed Investment Schemes (MIS).

In summary, the key points raised in this submission are:

- MIS is a common financial instrument used for a wide range of investment options in Australia and is not unique to forestry
- The MIS structure has proven successful in supporting plantation establishment as it addresses the characteristics that limit private investment in forestry activities, providing investment scale through pooling of investment funds
- Forestry MIS has led to the development of a substantial plantation estate that will provide a long term resource supply to industry, that will support further investment in processing capacity and boost industry competitiveness
- The resource established through MIS is unique in the Asia Pacific region, due to the clear ownership, legal right to harvest, sustainable management certification, wood type, quality and limited geographic spread
- The MIS structure and plantation taxation arrangement has been extensively reviewed over the past decade resulting in changes to the *Corporations Act* (through the Future of Financial Advice Reforms), ASIC disclosure requirements and new plantation taxation arrangements. However, with very little new plantation investment over the past five years (following the GFC), we have not been able to judge the success of these reforms.

- A few well managed, highly principled forestry MIS companies remain and should be allowed to continue to operate using the MIS structure and plantation taxation arrangement
- The MIS structure and plantation taxation arrangement should continue to be available to support new plantation investment
- If there are lingering concerns around the use of the upfront fee model for retail forestry MIS projects, they can be addressed by encouraging MIS companies to either establish a reserve account to hold sufficient funds in trust to see retail MIS projects to their conclusion, or a modification to the fee model to include a small trailing annual payment, to cover ongoing costs.