Nelson City Council
Te Kaunihera o Whakatū

OPEN

MINUTE ITEM ATTACHMENTS

Ordinary meeting of the

Forestry Subcommittee

Te Kōmiti Āpiti, Ngahere

Tuesday 23 March 2021
Commencing at 1.00p.m.
Council Chamber

Floor 2A, Civic House,

110 Trafalgar Street, Nelson

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Friends of the Maitai
Presentation to NCC Forestry Subcommittee
March 2021

The Friends of the Maitai will be present at the Forestry Subcommittee on March 23 to react to the draft Forestry Activity Management Plan (FAMP) and the forestry valuation presented in the previous Forestry Subcommittee (or Forestry Advisory Group) meetings. In the past few years, Friends of the Maitai has expressed our desire to see NCC manage its forestry asset in a regenerative manner demonstrating how forestry can both earn income and help restore Nelson's rivers and Tasman Bay.

It has been pointed out in previous meetings of this committee how the NCC forestry asset is being governed by the NCC Treasury and Investment Policy (TIP). Specifically, section 10.2 of the TIP lays out five criteria for governing NCC's commercial forests including:

- " To manage its forest estate on a sustainable basis and to maximise its net present value."

FoM considers this policy criterion as not fit for purpose. It must be re-worded to reflect a genuine attempt by NCC to manage the plantation estate sustainably on behalf of citizens and ratepayers.

Rationale

In this context, sustainable management means optimising economic returns while maintaining (and if necessary, restoring) ecosystem functions and services as well as social and community values. This means it is necessary to avoid, remedy or mitigate environmental and social impacts. Conventional forestry practice in New Zealand does not yet meet the definition because it continues to 'externalise' many environmental and social impacts.

While sustainability is a laudable objective, the policy to maximise net present value (NPV) is completely contrary to the notion of sustainability unless all costs are included. This contradiction occurs when environmental and/or social impacts occur as a result of forestry operations and when the costs of avoiding, remedying or properly mitigating those impacts do not appear in the accounts of the forest operations. Examples of impacts that create 'externalised' costs are sedimentation or pollution of rivers, streams and marine environments, loss of biodiversity, damage to private property or public infrastructure, and the loss of visual or physical amenity values.

The calculation of NPV (in this case, the current plantation value) involves discounting future costs and revenues back to the current time. The implication is that NPV is higher if any future costs are excluded from the calculation. Conversely, NPV is reduced if all costs are included and none are 'externalised'. In other words, if the costs of remediating or preventing pollution are not included in the costs of forestry, then the NPV appears higher than it actually is.

Another major issue with using NPV as a policy objective is the challenge of choosing a realistic discount rate. This is a somewhat arbitrary choice and should reflect the next best investment option for the investor. The discount rate used by PF Olsens in valuing the NCC forests is 6%. However, the 'implied' discount rate for recent forest transactions (sales) ranges from 3.2% to 8.7% for plantations of this size. More importantly, the fact that the choice of a discount rate is somewhat subjective and has a marked effect on NPV, makes NPV a poor choice as a policy objective.

In effect, NPV looks forward and attempts to estimate future costs and revenues. This is inherently flawed because none of these is known with any certainty.

Instead of second-guessing the future, a more accurate metric is to look back at the actual costs and revenues generated by the investment. In this case, a better measure of the financial performance of forest operations would be based on a long-run average of the annual profit before tax i.e. annual revenue minus annual costs with the average running over a period at least equivalent to the average rotation length.

This still requires the calculation of financial performance to include an estimate of the costs of avoiding, remedying and mitigating impacts on environmental and social values. In other words, ensuring that no costs are externalised to the environment or communities.

Section 10.2 of the TIP should therefore be amended to read that the council's policy should be:

"To manage its forest estate on a sustainable basis and to optimise long-run average annual profit while including the estimated costs of remedying environmental and social impacts."

ISSUES WITH FORESTRY VALUATION

Friends of the Maitai also has questions for the Council on how the NCC forestry asset has been valued. The NCC plantation is valued each year by PF Olsen. The valuation in June 2019 was $4.569 million. One year later (June 2020) it is valued at $7.115 million, a 55% increase. This rather extraordinary jump in value has occurred despite reported increases in forest insurance, roading and cartage costs, and lower forecast log prices as well as a loss of planted area (i.e. cutover not yet replanted and those areas being retired).

The main factors contributing to the increase in forest valuation are:

1. Updated forest inventory (adding $1.501 million).
2. A revision of the expected log grades in the forest (adding $1.277 million).
3. Growth in the forest over the last year (adding $240,000)
4. Inclusion of 84 ha of new replanted area (adding $230,000).
5. An update of the crop type yields (adding $198,000).

What is unusual and certainly questionable about these factors contributing to the increase is the basis for the first two. A forest inventory is based on measuring trees in sample plots. Olsens report that the measurement of trees in just 122 ha (of some 600 ha of the NCC estate) and a subsequent revision of yield tables has led to a 33% increase in the standing timber volume. One has to ask whether the sampling was truly representative of the entire estate and if so what has changed so significantly since the last inventory.

Secondly, a revision of the log grades modelled has resulted in a 28% increase in log grades in the forest.

This should be of some concern to the Council and a detailed explanation sought particularly around the methodology used and data obtained from the inventory process. A key question is when was the previous inventory performed.

ISSUES WITH NCC FORESTRY ACCOUNTS 30th JUNE 2020

The agenda for the NCC FAG meeting on 29th September 2020 included a 1-page financial report (Appendix 1, page 128 of the agenda).

There are some issues with the table as presented.

1. While the columns for Income appear to add up to the Total Income, the columns for Expenditure do not add up for Total Expenditure. No explanation for this is given.
2. Secondly, the increase in the forestry asset valuation has been included as income. While this may or may not meet the Accounting Standards for local bodies, the main question is whether this is a fair and proper illustration for the public of the actual financial viability of these publicly-owned forest assets. This point is even more pertinent given the highly unusual basis for the increase in the forestry asset valuation.
3. It should be noted that the increase in the forest value stated in the Olsen valuation report is $2,546,000 (page 166 of the agenda) while the forest accounts (page 128 of the agenda) has 'revaluation movements' entered as ($2,495,000). No explanation is given for this difference.

These are not small issues. They go to the heart of how the forestry asset is managed and the transparency of that asset to Nelson city residents and ratepayers. We call on the Forestry Subcommittee to address these issues in both the Long-Term Plan (LTP) and its presentation of reports to the public.