

# The changing face of forestry in the Central North Island

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## Introduction

Change is not new, it is neither good nor bad, it impacts every facet of society, it is inescapable and it is here to stay. The forest industry is not immune to change and the Central North Island (CNI) is no exception. The industry in the CNI is going through a period of relatively rapid change, but not at unprecedented levels of intensity or speed, even if it feels like it to those people who are directly involved. In this article I intend to make some comment on three aspects of the changes that are occurring that I feel will have the most significant effect over the next 12 to 24 months. These changes relate to land use, management intentions, and ownership. Overall my view is the change we are seeing is beneficial, reflecting as it does the impact of market forces in a dynamic market for land, wood fibre, and plantation forests.

I would like to note that the comments and opinions offered in this article are my personal views and do not reflect any formal position or stance on the part of my employer, Carter Holt Harvey Limited.

## Changes in Land Use

Changes in land use are a necessary and unavoidable consequence of the changing relative economic performance of different land-using industries, albeit that fundamental economic performance is distorted by subsidies from time

to time. The diagram below illustrates some of the significant changes in land use that have occurred in the CNI over the past few decades. The diagram is drawn from the author's memory so will have missed a few events.

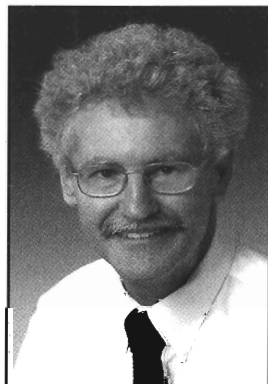
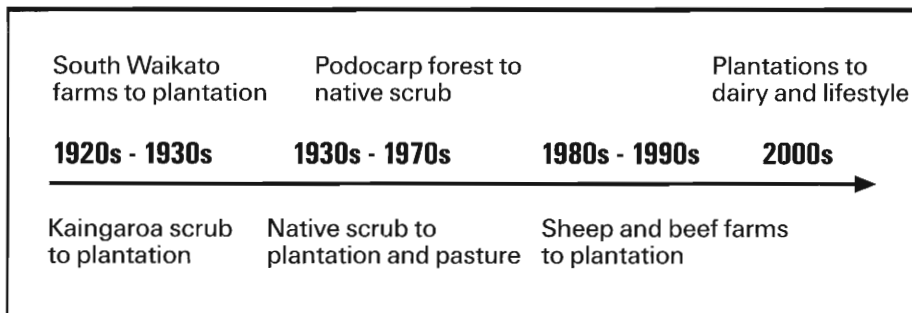
The core forests of the CNI estate, Kinleith and Kaingaroa, were established in the 1920s and 1930s on land that was uneconomic for farming. In the case of Kinleith the forest was established by an investment company that promoted forest investment and used the funds raised to purchase land and establish radiata pine plantations. The promotion was purely commercial and relied on access to low cost money, land, and labour.

At the same time basic economics meant that large areas of podocarp forest were being logged and converted to native scrub on private, Maori, and State owned land. This practice continued until relatively recently. Some of this land was subsequently converted from native scrub to plantations or to pasture, a land use change that was in part driven by government subsidies and in part by plantation forest economics. Large scale conversion of native scrub into plantations only came to a stop in the CNI with the removal of subsidies by the Labour Government in 1987, the disestablishment of the NZ Forest Service, and pressure from environmental groups that culminated in the signing of the NZ Forest Accord.

The declining economic performance of sheep and beef farming in the late 1980s and 1990s coupled with an optimistic view of the economic potential of plantation forestry resulted in conversion of pasture to trees on a relatively large scale. This position has now started to reverse as returns to dairy farmers have risen to the point that conversion of cutover plantation forest, on suitable

land, is an economic proposition. Quite significant areas of cutover land in the South Waikato have been converted to dairy over the past three years. The recently announced deal between Kiwi Forest Group and Landcorp involves the conversion of plantation land to pasture on a relatively large scale over a number of years. It is reasonable to suppose that this trend will continue until events change the relative economics of dairy farming, plantation forestry, and other land uses.

Two factors which will have a major impact on



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land use changes in the CNI in the near future are:

- The Government's imposition of a "deforestation cap", as part of its Kyoto package, limiting the area of land that can be converted out of trees without incurring a major deforestation tax.
- The imposition of restrictions on land use changes to control nitrate emissions in the Lake Taupo basin.

Both changes may result in a short term acceleration of land use changes before the relatively free market that has operated for the last two decades comes to an end.

The land use change away from plantations to dairy and other forms of agriculture that is occurring at present reflects the relative economic performance of the two industries. The surprising factor is how long it has taken for the change to gain significant momentum. The implication for the wood processing industries in the CNI is that there will be less wood available in the future than has been predicted. How much less is a bit of a puzzle - dairying may suffer a setback, the Government's deforestation measures, or even a rapid improvement in forestry's current performance could all change the trend.

**Management Intentions**

The late 1990s through to the end of 2002 saw the two major CNI forest owners increase harvest levels and decrease forest maturity. The common perception is that this strategy was adopted simply to generate cash. Nothing is ever that simple. A number of factors were behind this strategy:

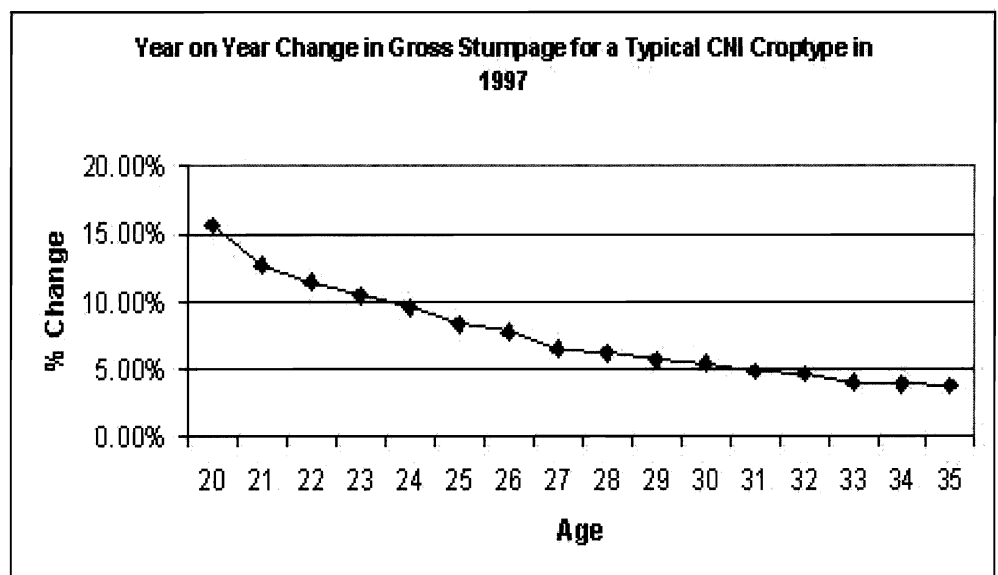
- Decision-making based on net present value favours current cash over future cash. The decision to hold forest for harvest later requires that biological growth and valuable improvement in quality (i.e. quality that someone is prepared to pay for) exceeds the cost of capital. This was not the case. The chart below shows that for a typical CNI crop type in 1997 (based on prevailing prices, costs, and expected year on year growth) there would

have been no reward for holding stands beyond age 24 -25. The lack of reward for older ages and associated better quality was a material factor behind the increase in CNI harvest in the period 1998-2002.

- Log prices rewarded size (length and diameter), branch size, and a very limited range of other quality characteristics. Pricewise a log from a 26-year-old tree was worth the same as a log from a 30-year-old tree.
- As maturity was falling from over 30 years the absolute impact of declining maturity on, for instance, structural sawmill performance has taken some time to become apparent.
- Favourable exchange and freight rates provided an expanding profitable demand for logs in Asia. For example in 2002 freight rates reached US\$14 - 15/JAS against a long run average of US\$25 - 28/JAS, while at the same time the US exchange rate was below 50c.

Last year saw a major change in strategy with reductions in harvest levels from both major CNI estates with the purpose of building maturity. So what has changed?

- Average prices have fallen, increasing the option value of waiting in anticipation that prices will improve in the future.
- Sawmills are starting to pay for quality characteristics other than size. Tenon and others are paying premiums for logs from stands that fit specified density characteristics, reflecting higher lumber recovery. One can argue that density is not the best characteristic to focus on, however the move signals a change to rewarding forest owners for characteristics which are favoured by longer rotations.
- Carter Holt Harvey has moved to a harvest pro-



file for Kinleith Forest that will ultimately see rotation ages sitting in the 28 - 32 year band. This decision is based on factors such as maintaining density and stiffness for structural log customers, maintaining piece size and volume at levels that create the conditions needed for lower harvesting cost, balanced against the cost of capital. The decision anticipates that absolute log prices, price differentials and cost reductions will generate a return on the investment in deferred income.

The net effect of these changes has been a reduction in available wood supply in the CNI which has mainly been apparent as a reduction in log exports to Asia and a relatively stable domestic market. It is unlikely that harvest levels will lift again for sometime.

### Ownership

Change in forest ownership, like change in land use, has been a feature of the industry since its inception. The most notable changes have been:

- The disengagement of the State through the disestablishment of the NZ Forest Service and subsequent sale of the State plantation estate to private ownership.
- The recent move in private ownership from corporate to private investor ownership, either through direct or TIMO investment.
- Separation of ownership of land and trees across large parts of the estate.

It is somewhat ironic that the Government, through nationalisation of carbon credits, is reacquiring property rights in assets that it has only recently sold, and through agencies like the NZ Super Fund will most likely become a direct investor again in the future.

One of the more notable features of recent changes in ownership is the number of new names that have appeared - GFP, Hancock, Kiwi, Prudential, Harvard. None of them have any direct interest in wood processing in the CNI, signalling a shift in the level of vertical integration in the industry.

Some consequences from these changes are already apparent; i.e. the change in land use encompassed by the Kiwi / LandCorp deal and Harvard's strategy of reducing harvest levels from Kaingaroa. The move away from vertical integration has created an environment that may foster the development of longer term supply contracts than have been the norm over the past decade. At the same time the volume of wood being offered for sale as stumpage as a means of price discovery, market testing, and volume


disposal may increase in the future. The market for wood fibre in the CNI is likely to remain dynamic and is, if anything, likely to become increasingly competitive.

A significant proportion of the new ownership in the CNI is only invested in the current crop. It remains to be seen whether or not this signals further land use changes in the future and, of course, leaves open the question as to who will own the next rotation if it is planted.

The net effect of recent changes in ownership is most likely to be positive. Overall I would expect to see a more dynamic wood fibre market evolve with an associated increase in supply volatility. Recent land use changes are likely to continue given the separation of land and tree ownership affected by some recent ownership changes.

### Conclusion

Recent changes in land use, management, and ownership of the CNI are simply part of the continuous change that has been occurring since the inception of the plantation forest industry in the CNI in the 1920s and 1930s. These changes, which are generally positive, reflect market economics. I hope the current dynamic market for land, wood fibre, and plantation forests persists into the future to the long run benefit of the industry.




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