

# The Treasury

## Overseas Investment Forestry Information Release

### Release Document

February 2019

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**Treasury Report: Overseas Investment in Forestry -  
Follow-up Oral Item at Cabinet 12 March**

<b>Date:</b>	Friday 9 March	<b>Report No:</b>	T2018/560
		<b>File Number:</b>	IM-5-8-1

**Action Sought**

	<b>Action Sought</b>	<b>Deadline</b>
Minister of Finance (Hon Grant Robertson)	<b>Refer</b> this report to the Deputy Prime Minister, Minister for Crown Maōri Relations, Minister for Māori Development, the Minister for Climate Change, the Minister for Forestry and the Minister for Land Information.	Friday 9 March
Associate Minister of Finance (Hon David Parker)	<b>Report</b> to Cabinet via an oral item on Monday 12 March with any proposed changes to the screening regime or for further consultation with iwi and Māori groups, based on the advice provided in this report	Monday 12 March

**Contact for Telephone Discussion (if required)**

<b>Name</b>	<b>Position</b>	<b>Telephone</b>		<b>1st Contact</b>
Steve Cantwell	Principal Analyst	[7] (wk)	[3] (mob)	✓
Thomas Parry	Team Leader, Overseas Investment	[7] (wk)	[3] (mob)	

**Actions for the Minister's Office Staff**

**Forward** this report to the Deputy Prime Minister, Minister for Crown Maōri Relations, Minister for Māori Development, the Minister for Climate Change, the Minister for Forestry and the Minister for Land Information.

**Return** the signed report to Treasury.

Note any feedback on the quality of the report

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**Enclosure:** No

# Treasury Report: Overseas Investment in Forestry - Follow-up Oral Item at Cabinet 12 March

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## Executive Summary

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This report provides advice and options for recommendations to support taking an oral item to Cabinet on Monday 12 March to fulfil the report back added at Cabinet on 5 March in consideration of the paper 'Overseas Investment in Forestry'.

On 5 March Cabinet agreed to enable easier screening of forest purchases by adding an alternate path to meeting the current Overseas Investment Act (OIA) screening test (CAB-18-MIN-0071.01 refers).

### Domestic Processing

We understand Ministers have concerns that making it easier for foreign investors to purchase forestry land and forestry rights may lead to more logs being sent off-shore for processing, with negative impacts on local log supply for domestic processing, employment in domestic processing and associated industries, and investment in new or upgraded processing facilities.

MPI notes that many of the challenges that domestic wood processors are facing in accessing a secure supply of logs cannot be resolved through the screening process contained in the OIA. For example, high export log prices, low shipping costs, [1] lack of suitable logs for local sawmilling facilities and lack of scale may all be contributing factors. MPI is working with key forestry industry stakeholders and developing advice to Ministers on options for addressing security of supply issues as well as advice on how to support greater use of wood in New Zealand building and construction.

This paper outlines 5 options for additions to the alternative pathway for screening overseas investments in forestry.

[1] [2] [5]

Therefore at this stage we suggest Ministers consider either retaining the status quo as agreed by Cabinet, or implementing a low-cost option now, [1]

### Impacts on Maori Economic Interests

We understand that there are a range of concerns about the forestry proposals with respect to Māori and iwi interests, including the truncated timeframes for consultation with Māori and iwi groups due to the need to implement legislative changes prior to CPTPP entering into force, [1]

and hamper efforts to convert Maori freehold land to forest, and the potential disruption of current negotiations for the sale of forestry rights.

The issues raised by iwi/Māori are significant and, for some, have immediate impact. We have not identified viable policy options for addressing these concerns at this stage as we consider further engagement is needed to clarify the nature of concerns and the extent to which changes since the initial consultation occurred may address these.

Given the time constraints, further consultation with iwi and Māori groups could proceed alongside the legislative process, with the potential for changes to the legislation at the Third Reading of the Bill. This would be in addition to the public submissions process likely to occur during Select Committee consideration of the SOP.

## Recommended Action

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We recommend that you:

- a **note** that on 5 March, Cabinet (CAB-18-MIN-0071.01 refers):  
“invited the Minister of Finance, the Associate Minister of Finance (Hon David Parker), the Minister of Forestry and the Minister for Crown/ Maori Relations to report to Cabinet on 12 March 2018 with any changes to the screening regime to be applied to the Statutory Forestry Rights and forestry-related profit a prendre that exist outside the Forestry Rights Registration Act, including advice on the pros and cons of any alternative approaches to security of supply for domestic wood processors and impacts on Māori economic interests”.
- b **refer** this report to the Minister for Crown Māori Relations and the Minister for Forestry.  
*Refer/not referred.*
- c **note** that on 5 March, Cabinet (CAB-18-MIN-0071.01 refers):  
“authorised a group of Ministers consisting of the Deputy Prime Minister, the Minister for Crown/Māori Relations, the Minister of Finance, the Associate Minister of Finance (Hon David Parker), the Minister for Māori Development, the Minister of Forestry, the Minister for Climate Change and the Minister for Land Information to have Power to Act on further detailed policy matters that may need to be addressed;”
- d **refer** this report to the Deputy Prime Minister, Minister for Māori Development, the Minister for Climate Change, and the Minister for Land Information;  
*Refer/not referred.*
- e **note** the suggested draft recommendations for consideration at Cabinet on 12 December.

Thomas Parry  
**Team Leader, Overseas Investment**

Hon Grant Robertson  
**Minister of Finance**

## **Treasury Report: Treasury Report: Overseas Investment in Forestry - Follow-up Oral Item at Cabinet 12 March**

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### **Purpose of Report**

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1. This report provides advice and options for recommendations to support taking an oral item to Cabinet on Monday 12 March to fulfil the report back added at Cabinet on 5 March in consideration of the paper 'Overseas Investment in Forestry'.

### **Analysis**

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2. On 5 March, Cabinet agreed the recommendations in the paper 'Overseas Investment in Forestry' and also added a further recommendation (CAB-18-MIN-0071.01 refers):  
  
"invited the Minister of Finance, the Associate Minister of Finance (Hon David Parker), the Minister of Forestry and the Minister for Crown/ Maori Relations to report to Cabinet on 12 March 2018 with any changes to the screening regime to be applied to the Statutory Forestry Rights and forestry-related profit a prendre that exist outside the Forestry Rights Registration Act, including advice on the pros and cons of any alternative approaches to security of supply for domestic wood processors and impacts on Māori economic interests".
3. This report outlines the concerns about security of supply of wood for domestic processors and Māori economic interests as they are understood by officials and explores options for addressing them. We understand that Ministers intend to report back to Cabinet on 12 March through taking an oral item. Although the above Cabinet minute focusses on Statutory Forestry Rights and forestry-related profit a prendre, the analysis in this report also applies to freehold and leasehold forestry land.
4. This report has been prepared under tight timeframes.

### **Addressing concerns about local supply of timber and domestic processing**

#### *Our understanding of the concerns*

5. Cabinet agreed to enable easier screening of forest purchases through an alternate path to meeting the current benefits test under the Overseas Investment Act (OIA) in the form of a set of criteria specified in regulations. This decision responds to a concern raised through stakeholder engagement that the current forestry screening regime is not fit for purpose and it is difficult for forestry investors to demonstrate that investments will provide substantial and identifiable benefit to New Zealand. Quality foreign investment in plantation forest is important for the success of the forestry sector and the long term viability of the domestic wood processing sector. As such, easier screening supports a number of this Government's priorities.
6. However, we understand Ministers have concerns that making it easier for foreign investors to purchase forestry land and rights may lead to more logs being sent off-shore for processing, with negative impacts on local log supply for domestic processing, employment in domestic processing and associated industries, and investment in new or upgraded processing facilities. This outcome would be inconsistent with the Government's objectives relating to local supply of logs and domestic processing, increasing the residential housing stock and regional development and employment.

7. Some of the criteria agreed by Cabinet on Monday support future log supply, or immediate log supply to domestic processors. The criteria for the alternative path for investors will include that [CAB Min CAB-18-MIN-0071.01 refers]:
  - felled areas will be replanted, where the investor obtains an interest that allows the investor to replant (eg. a freehold or leasehold interest), and
  - existing commitments to provide logs to domestic customers are maintained.
8. Also, liberalising the regime for investment in forestry land will likely increase foreign investment, which may increase the size of plantation forestry and future harvest volumes. This may result in increased domestic processing activity where the logs are suitable for domestic processing and processors are able to negotiate appropriate supply arrangements with forest owners.
9. The current Ministerial directive letter (MDL) to the Overseas Investment Office helps guide the OIO's application of the Overseas Investment Act (OIA). A Ministerial directive letter may direct the regulator about the Government's general policy approach to overseas investment in sensitive New Zealand assets, including the relative importance of different criteria or factors in relation to particular assets. The current MDL contains a section on investments in forest land (Annex 1). That touches on Ministers' concerns as seeks to encourage an increase in the value added processing of raw products and the advancement of its forestry-related strategies.

### **Other Work Currently Underway**

10. MPI notes that many of the challenges that domestic wood processors are facing in accessing a secure supply of logs cannot be resolved through the screening process contained in the OIA. For example, high export log prices, low shipping costs, [1] lack of suitable logs for local sawmilling facilities, lack of scale and poor negotiating practices of some wood processors may all be contributing factors.
11. MPI has identified some preliminary options for addressing these issues:
  - better information for small farm-foresters;
  - improved transparency and structure to support log markets;
  - greater oversight of log exporters;
  - investigating current regulatory settings for the provision of forestry investment and management advice; and
  - [1]
12. Detailed work is required to assess these options further and identify the costs, benefits and risks associated with them, and to develop specific proposals for Ministers to consider. [1] [2] [5]
 

and it will be important that

policies that support domestic processors do not have unintended impacts on other sectors or groups.

13. MPI will be working with key forestry industry stakeholders (from across the forest growing and processing value chain) and developing advice to Ministers in 6 – 8 weeks on options for addressing security of supply issues as well as advice on how to support greater use of wood in New Zealand building and construction (i.e. a 'Wood First' policy).

### **Options for addressing the concerns by adjusting OIA screening criteria**

14. We have identified five options for addressing these concerns:

#### ***Option 1- Ensuring overseas investors understand the Government's direction for forestry***

15. This would require investors to declare that they had read and understood the government's direction for forestry. This is the lightest-touch option, so is the most consistent with the forestry checklist providing a permissive alternative to the usual OIA screening tests,<sup>[1]</sup>
16. Potential avenues for signalling the government's direction on forestry include the forestry elements of the MDL to the (OIO), or a government forestry strategy. Both of these are potentially problematic.
17. The MDL was drafted to reflect the requirements of the OIA (eg it is a directive to the regulator about the Government's general policy approach to overseas investment in sensitive New Zealand assets and the relative importance of criteria), and in this instance is focused on the substantial and identifiable benefit test. It was not intended to regulate investors directly and would need to be amended before being used for a purpose for which the current letter is not intended. There may also be a requirement to change the current OIA empowering provisions regarding the MDL.
18. On the other hand, relying on a government forestry strategy would require developing that strategy. This has proved difficult in the past due to the different perspectives of a wide range of stakeholders. It will also likely be a very broad document, covering many more matters than the issues of concern to Ministers that this provision would be attempting to highlight to foreign investors.

#### ***Option 2 – Overseas investors need to demonstrate a willingness to contribute towards the Government's direction for forestry***

19. This would involve an additional criterion in the new forestry screening test requiring investors to provide evidence that they are willing to contribute towards the Government's direction for forestry as outlined in the MDL, or forestry strategy, as per option 1.
20. The advantage of this option is that it minimises disincentives to investment by allowing potential investors to determine how they will contribute to the Government's direction for forestry and the costs associated with their contribution. In contrast to option 1, the investor will need to steps that contribute to the Government direction on forestry.
21. The disadvantages of Option 1 also apply for Option 2. In addition there will need to be some level of OIO assessment to ensure the investor has interpreted the Government's direction correctly and their course of action shows a willingness to contribute towards it. This could be challenging to apply due to the ambiguity of determine what is required to comply, and moves away from a bright line check list to requiring judgement-based OIO assessments of compliance.

### **Option 3- Local offer of forests**

22. This would require *vendors* of forest land selling to overseas investors to have first offered the land for acquisition on the open market to New Zealand persons or New Zealand owned businesses. This would extend to forest land existing OIA requirements for sales of farm land<sup>1</sup> to overseas persons, and would require only a small legislative change to implement. Vendor advertising of the relevant forest land or rights would be a pre-condition for overseas investors accessing the checklist pathway for OIO consent.
23. This option responds to [1] by promoting domestic ownership of forestry assets, in the expectation that domestic owners are more likely than foreign owners to supply wood for domestic processing. MPI note that this expectation may be incorrect, as the supply decisions of [1] are strongly shaped by relative domestic and international prices, and shipping costs.
24. This option would give domestic processors more opportunity to vertically integrate by buying forest land and rights. [1] and would often have low or no additional costs for vendors, where the land is already offered domestically for commercial reasons.
25. While the use of standing consents presents a challenge for this option, this could be managed by OIO requiring vendor advertising as a pre-condition for acquisitions using the standing consent. The OIO advise that the obligation need not be overly costly or necessarily result in delays in the sales process. However, like option 1 and probably 2, it does not directly target providing wood for domestic processing.
26. [1] [2] [5]

### **Option 4 – Enhancing current offers of wood**

27. This option would involve strengthening the criteria in the new forestry screening test that requires investors to ‘maintain’ any existing commitments to domestic log processors, to require that these commitments to be *enhanced* (e.g. “*commitments to provide logs to domestic customers are enhanced*”).
28. The advantage of this option is that it reduces disincentives to invest by allowing potential investors to determine how they will ‘enhance’ local supply arrangements, therefore giving investors control over the solution and associated costs. Examples of how investors could ‘enhance’ existing commitments include: providing more logs to the same processors; supplying the same processors plus some additional processors; and supplying the same amount to the same processors but for a longer timeframe or at a lower price.

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<sup>1</sup> The Overseas Investment Act defines farm land as land used exclusively or principally for agricultural, horticultural, or pastoral purposes, or for the keeping of bees, poultry, or livestock.

29. The disadvantages of this option are that it has features that are a source of difficulty with the current screening regime, and that the checklist is seeking to avoid - it is not a bright-line test, as would require the OIO to assess if the investors proposal would enhance domestic supply commitments, and could be a difficult condition to meet if the forest being purchased already devoted all or most of its logs to domestic supply. Also as it would be a requirement, as opposed to a benefit factor that it is optional for the investor to address, it would be more onerous than the similar "increased processing of primary products" benefit factor that exists under the existing screening regime. [1] [2] [5]

### ***Option 5- Local offer of wood***

30. This option add to the criteria agreed by Cabinet a consent criterion that overseas investors commit to offer, on the local market, wood for acquisition by domestic processors (and other users). This option targets most directly Ministerial concerns that further measures may be required, beyond the recent Cabinet agreement that the new approval pathway include a requirement that existing commitments to provide logs to domestic customers are maintained.
31. From the investors' perspective this is the most intrusive option, and the most likely to reduce investor interest in forestry assets. As it is compulsory, this requirement is more onerous than the "increased processing of primary products" benefit factor in the current screening test. The reduced investor interest would likely appear as a mix of a reduction in market activity, and lower prices for these assets.
32. [1] [2] [5]

[5]

Therefore if chosen, its development would likely be on a separate slower path than the forestry SOP and draft accompanying regulations, and added by regulation at a later date.

### ***Officials' advice***

33. The MPI-led work on security of supply for processors, and supporting the greater use of timber in building and construction forestry, may prove a more fruitful approach than imposing obligations on overseas buyers of forests, but is on longer timeframes than the current forestry SOP.

34. [1] [2] [5]

Therefore at this stage we suggest Ministers consider either retaining the status quo as agreed by Cabinet, or implementing a low-cost option now and reassessing later this year after the broader policy work on forestry and wood products is completed.

35. In weighing up the trade-off between potential positive impact on domestic supply and employment and the potential negative impact on foreign investment in forestry, the Treasury would favour options that minimise the efficiency costs of any obligations, as efficiency costs tend to flow through to higher structural costs for the sector as a whole. On that basis we would recommend retaining the current status quo as agreed by Cabinet (including the obligation to honour existing domestic supply contracts). If Ministers wish to go further, on the information available Treasury and OIO prefer option 3 – vendor advertising, as it draws on existing OIA frameworks, relatively low-cost and will likely have some positive effect.

### **Impact of forestry proposals on Māori economic interests**

#### *Our understanding of the concerns*

36. We understand that there are a range of concerns about the forestry proposals with respect to Māori and iwi interests, including:

- The truncated timeframes for consultation with Māori and iwi groups [5]
  
- [1] including land returned to iwi through the Treaty of Waitangi settlement process, and forestry rights sold in future, creating potential for this to provoke legal action by affected iwi.
  
- That screening forestry rights will [1] hamper efforts to convert small holdings of Maori freehold land to forest, including through aggregation arrangements.
  
- The potential for the proposal to disrupt current negotiations for the sale of forestry rights.

37. Regarding truncated timeframes, as the Cabinet paper noted:

*“The process saw the sharing of a consultation document and facilitation of four hui in regions across New Zealand over the Christmas/New Year period. This was undesirable timing but the CPTPP deadline meant we had limited options for consultation. [5]*

[5]

*(Legally privileged).”*

38. [1]

39. On the other hand, more permissive screening of forestry land purchases will increase investor certainty and reduce compliance costs, potentially increasing the value of forestry assets, with positive balance sheet impacts for forestry asset owners. We have not analysed what the overall impact of these opposing influences might be on forestry asset values, although would expect the impacts to vary significantly across different owners, reflecting differences in the forests (including age, current harvest cycle, location), forest owners, management practices and contracting arrangements.
40. [4]
41. Given the time constraints, further consultation with iwi and Māori groups could proceed alongside the legislative process, with the potential for changes to the legislation at the Third Reading of the Bill. This would be in addition to the public submissions process likely to occur during Select Committee consideration of the SOP and draft regulations (subject to timing allowing Select Committee consideration of the SOP and the Committee deciding to seek public submissions). This would provide iwi and Māori groups two avenues for to have their concerns explored and addressed – directly with the executive, and through Parliamentary process.
42. Other options to give more space for discussion with Maori/ iwi before presenting a proposal, such as temporarily exempting sales of forestry rights to overseas persons by Maori/ iwi groups, [1] [2] [5]
- Any exemptions for Maori/ iwi related transactions would then risk becoming permanent.
43. [5]

## Next Steps

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44. Attached as Annex 2 are some suggested recommendations to help support discussions of this oral item at Cabinet on Monday 12 March.

## **Annex 1: Forest Land Section of Current Ministerial Directive Letter (of 28 November 2017) to the Overseas Investment Office**

### *Overseas investments in forest land*

1. The Government recognises that overseas investment in the forestry sector, and the associated downstream processing industries, has the potential to add significant value to the overall economy and the environment.
2. The Government wishes to encourage an increase in the value added processing of raw products and the advancement of its forestry-related strategies. The Minister therefore directs the regulator that the following factors will generally be of high relative importance for overseas investments in ‘forest land’<sup>2</sup> (the forest land directive):
  - 2.1. The ‘increased processing of primary products’ factor (section 17(2)(a)(vi)); and
  - 2.2. The ‘advance significant Government policy or strategy’ factor (regulation 28(f)).
3. The Minister would generally expect the regulator to impose specific conditions of consent on overseas investors whose investment plan involves processing in New Zealand. These could include, where appropriate, a condition requiring the overseas investor to enter into a supply arrangement with a local processor. Conditions imposed on overseas investments in forest land may need to be imposed for longer periods given the often long-term nature of such investments.

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<sup>2</sup> For the purposes of this directive letter, ‘forest land’ means land that is non-urban and over 5 hectares in size (excluding any associated land), where the existing principal use of the land is forestry.

## **Annex 2: Suggested Recommendations for Cabinet on Monday 12 March**

**Note** on 5 March, when considering the paper 'Overseas Investment in Forestry', Cabinet added a further recommendation, inviting:

“the Minister of Finance, the Associate Minister of Finance (Hon David Parker), the Minister of Forestry and the Minister for Crown/ Maori Relations to report to Cabinet on 12 March 2018 with any changes to the screening regime to be applied to the Statutory Forestry Rights and forestry-related profit a prendre that exist outside the Forestry Rights Registration Act, including advice on the pros and cons of any alternative approaches to security of supply for domestic wood processors and impacts on Māori economic interests”.

### ***On security of supply for domestic wood processors:***

**Note** that, independently of this work on overseas investment in forestry, MPI is working with key forestry industry stakeholders developing advice to Ministers on options for addressing security of supply issues and advice on supporting greater use of wood in New Zealand building and construction.

[1] [2] [5]

EITHER:

**Agree** that no new regulations regarding supply of wood to domestic processes be developed at this time, beyond those specified in Cabinet minute CAB-18-MIN-0071.01;

OR

**Agree** that the new approval pathway for overseas investors in forestry include a requirement that the investor understands the government's direction for forestry (the mechanism for this to be decided later).

OR

**Agree** that the new approval pathway for overseas investors in forestry include a requirement that the investor is willing to contribute towards the government's direction for forestry (the mechanism for this to be decided later).

OR

**Agree** that a prerequisite to access the new screening pathway be that vendors of forestry land and/or rights be required to have first offered the land for acquisition on the open market to non-overseas persons

OR

**Agree** that the new approval pathway for overseas investors in forestry include a requirement that commitments to provide logs to domestic customers are enhanced

OR

**Agree** that purchasers of forestry land and/or interests utilising the new consent pathway be required to commit to offer, on the local market, wood for acquisition by domestic processors (and other users).

***On the impact of forestry proposals on Māori economic interests:***

**Agree** that further consultation be undertaken with iwi and Māori groups alongside the legislative process, with the potential for changes to the legislation through a supplementary order paper (SOP) at the Third Reading of the Bill.

**Note** that this would be in addition to the public submissions process likely to occur during Select Committee consideration of an earlier SOP implementing the proposed new screening pathway for forestry investment.