

The Treasury

Overseas Investment Act 2005 – Phase One Review Policy Advice (2017/18) Information Release

March 2019

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Treasury Report: Treasury Report: Overseas Investment in Forestry - A new option for screening of land to be converted to forestry

Date:	Wednesday 9 May 2018	Report No:	T2018/1282
		File Number:	IM-5-8

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Grant Robertson)	Note the contents of this report	None.
Associate Minister of Finance (Hon David Parker)	Provide feedback to Treasury officials on the new option.	Provide feedback to Treasury officials by Wednesday 16 May to enable any changes to be drafted into the Cabinet Paper to be lodged Thursday 17 May.

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
[4]	Analyst, Overseas Investment	[6]	N/A (mob)	✓
Dasha Leonova	Manager, Overseas Investment, International and Financial Markets	[6]	[6]	

Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report

Enclosure: No

Treasury Report: Overseas Investment in Forestry - A new option for screening of land to be converted to forestry

Purpose of Report

1. This report responds to your request for a way forward regarding the treatment of freehold and leasehold land that is intended to be converted to forestry under the new forestry screening regime.
2. As you are aware, the Treasury is drafting a Cabinet Paper on changes to Supplementary Order Paper No.19 (SOP) to the Overseas Investment Amendment Bill which deals with the introduction of forestry rights and changes to the screening tests for overseas investments in forestry. That Cabinet Paper is to be lodged with the Cabinet Office by Thursday 17 May 2018. We understand that Ministers are considering options on how to respond to submitter concerns with the SOP proposals for screening of investments in land to be converted forestry. This paper outlines an option we have not previously tested with you.

Background

3. The SOP introduces two new screening tests to the Overseas Investment Act with regard to forestry investments;
 - a. The **special benefits test** is intended to be a simplified objective checklist, in addition to the existing investor test, which is considered to be met if the overseas investor meets all conditions specified in a six-point checklist.¹
 - b. The **modified benefits test** retains the existing investor test and 21 benefit factors and compares what would happen if the investment proceeds versus if it does not and the land was instead retained by the current owner (rather than against a hypothetical overseas investor). It is modified from the status quo in that the counter-factual test is easier for the overseas investor to understand and apply.²
4. The SOP proposes that the special benefits test cannot be used for land which is acquired under a freehold or leasehold transaction with an intention to convert to forestry. Those investors must instead use the modified benefits test. This is more onerous than the special benefits test as it requires the investor to demonstrate that the investment provides a substantial and identifiable net benefit to New Zealand. Therefore its assessment is more complex than the special benefits test “checklist”.

¹ The special benefits test in the SOP requires that the investor maintain any existing arrangements for the protection of significant areas of vegetation and habitats of fauna, the protection of historic heritage, and the providing of public access for walkers.

² Section 17 of the OIA currently lists a number of benefit factors that are relevant to biodiversity, for example; whether there are or will be adequate mechanisms in place for protecting or enhancing existing areas of significant indigenous vegetation and significant habitats of indigenous fauna

The special benefits test can be used for conversion to forest through forestry rights, however.

5. A decision has not yet been reached by Ministers on whether to extend the use of the special benefits test to forestry conversions under leasehold or freehold transactions. We understand that Ministers have a concern around extending the simpler special benefit tests to these types of conversions, in particular, ensuring the protection of biodiversity on land which is not yet forestry. Allowing an overseas investor to use the simpler special benefits test to purchase large areas of land with an intention to convert to forestry heightens the risk of investments that reduce biodiversity values.
6. The Treasury's preferred position is that conversion to forestry via forestry rights, freehold or leasehold arrangements should be available under the modified benefits test, rather than the special benefits test [T2018/987 refers]. However, the option presented in this paper is workable.

A Possible Way Forward on Conversion

7. This option attempts to address concerns that the special benefit test places insufficient biodiversity protections on forest conversions by overseas investors, while also enabling the special benefits test to be used when those biodiversity concerns are met. We are keen to test your interest in this option and whether it is useful to include this option in the Cabinet Paper to be lodged next Thursday.
8. At a high level, this proposal would require an overseas investor looking to acquire freehold or leasehold land with an intention to convert to forestry to use the modified benefit test (per the SOP), unless the Overseas Investment Office (OIO) is satisfied that either:
 - a. The land in question contains no existing areas of significant indigenous vegetation or significant habitats of indigenous fauna; or
 - b. If there are such areas, they are already sufficiently protected.
9. If these biodiversity checks are passed, the investor could apply for approval under the special benefits test. The biodiversity prerequisite would act as a "gate" the investor would need to satisfy for freehold and leasehold land conversions, in addition to the criteria under the special benefit test. It would not constitute a new test, but rather an additional element to complete alongside the special benefit test application.

How could it operate in practice?

10. This option is in the early stages of design. In broad terms the relevant Minister, or OIO, would need to be satisfied on the biodiversity questions before approving any consents under the special benefits for purchases or leases of land for conversion to forestry. The OIO is already often required to do this under the existing benefits test, e.g. in cases when an investor seeks to demonstrate biodiversity benefits from their investment. Typically the investor and/or vendor develop or commission a biodiversity stock-take and protection plan. In some cases, this information may be held by the regional or district council. If the relevant information concludes that there are no significant indigenous vegetation or significant habitats of indigenous fauna, the vendor or investor can apply for consent to convert the land under the special benefits test. This information would be proof of entitlement to use the special benefits test (much like providing proof that the transaction concerns forestry rights, or is an existing forest in other circumstances).

11. If there is significant biodiversity warranting more protection, the investor would need to use the modified benefits test. However other responses would also be possible. For instance the vendor could increase protection of the identified area sufficiently to make the special benefits test available to the investor. Or it may be that some or all of the land for conversion could be retained by the vendor and be converted using forestry rights (which can automatically access the special benefits test) rather than an outright sale of land.

What are the benefits of this approach?

12. The new option represents a liberalisation of what is currently in the Act and what is in the SOP currently before the Select Committee. This approach seeks to widen the applicability of the special benefits test to a wider class of forestry investments. The special benefits test is intentionally designed to be streamlined, efficient and more certain for investors and it will be desirable for investors to use it where it is an option.
13. The approach prioritises the resource of the OIO to assessing applications of most concern. Where a more straightforward conversion has been identified as having no significant values to protect, it can go through the more streamlined special benefits checklist. In cases that are more complex and a plan or conditions to protect these values is required, the investor and the OIO can work through this via the modified benefits test consent process.

What risks does it pose?

14. The SOP greatly reduces, but does not eliminate, the existing inconsistency between the OIO screening of forest conversions [1] This option further reduces, but does not eliminate, the remaining inconsistencies (by making the special benefits test available for land conversions in some situations)³. There is a risk that the lighter regulatory burden on forestry rights continues to skew the behaviour of investors towards forestry right investments, albeit less than is currently the case. [1]
15. This option only responds to biodiversity protection concerns regarding the use of the checklist. It does not address other benefit factors potentially of concern to Ministers that are included in the modified test, but not the special benefit test. Examples include creation of new jobs, increased processing of primary products, and protecting or enhancing walking access or historic heritage. While in principle other factors of concern could be added, the more that are added the closer this option comes to reinventing the modified benefits test.
16. This option does not address avoidance concerns with the SOP design, namely that investors seeking long term investments in New Zealand forestry assets may use the special benefits test to convert land under a forestry rights arrangement, and then swap the forestry right for a freehold or leasehold arrangement after that land becomes forest (and so be eligible for the checklist). Utilising this 'loophole' is not without risk to the investor however.
17. Under this option, OIO approval of the biodiversity status of the land would be required alongside the checklist. This is at odds with the design of the checklist, which is intended to support self-assessment, and would significantly complicate the application of standing consents to forest conversions. However this complexity would only apply for land being converted to forest (and not for forestry rights, or land that is already forested).

³ This inconsistency has been identified by submitters, including the Wood Processors and Manufacturers Association.
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18. The cost of an independent environmental consultancy report could be as high as \$50,000 - \$100,000 for large properties and may likely be required to provide the necessary information to the OIO. This may be a deterrent for some investors. However, this cost isn't necessarily a new one as these types of reports can be required to seek consent to convert land under the Resource Management Act 1991, or may be done in the course of due diligence for large transactions. This type of information may already be held by local or regional councils if they have already identified significant natural areas in their regional district plans. It may also be a small cost in the terms of large scale long term investments. For example a \$50,000 report for a 5000ha investment is an additional cost of \$10 per hectare.

Is the option workable?

19. The initial assessment of a workshop attended by officials from Treasury, OIO, DoC, MPI and TPK on 8 May is that that this option is workable, and could be used a mechanism to address competing concerns around encouraging overseas investment to help the Government deliver on its 1 Billion Trees commitment and ensuring protection for significant indigenous vegetation and fauna values.
20. MPI conclude that this proposal does not provide any clear identifiable benefit above what would ordinarily be required under the Resource Management Act. They note that land-use consent for forestry under the RMA would require a biodiversity report where the conversion is not already a permitted activity. MPI continue to support freehold and leasehold conversion investments having unrestricted access to the special benefits checklist.
21. The RMA relies on implementation by regional and district councils so may have variable consideration of significant biodiversity values. The Treasury notes that although the RMA is the primary legislative tool for managing land use and its impacts, the OIA is an existing additional regulatory tool for managing impacts of, and addressing community concerns regarding, overseas-sourced investment. Therefore relying only on the RMA would be inconsistent with the existing statutory design (which includes the OIA recognition that it is a privilege for overseas persons to own or control sensitive New Zealand assets, and enables consent conditions to be imposed).

What other options were considered?

22. Officials considered whether any existing information held by Government could be a useful determinant of whether the investor would need to satisfy the OIO that significant values were protected before being able to meet the special benefit test. The quality of information held by local or regional councils varies, so it would not be a robust method to use this to inform which areas are significant biodiversity areas. MPI are developing geo-spatial maps to highlight areas suitable for forestry planting under the 1 Billion Trees Programme, but these will not be at a level granular enough to identify protected fauna for example.
23. The way forward proposed in this paper represents what officials' consider the most pragmatic and streamlined option given the information available to vendors and investors to identify and protect significant biodiversity values, to address concerns expressed by Ministers.

Next Steps

24. We recommend that you consider the option raised in this paper, and provide feedback to the Treasury so that we can make any required changes to the draft Cabinet Paper ahead of the intended lodgement date of 10:00am Thursday 17 May.

Recommended Action

We recommend that you:

- a **note** the new option provides for screening under the special benefits test of freehold and leasehold land to be converted to forestry, if the land has no significant biodiversity requiring special protection, or adequate biodiversity protections are in place.
- b **note** that this does not constitute a new test or pathway, but rather, an additional step that the investor must complete if using the special benefits test when buying or leasing land to convert to forestry.
- c **provide feedback** on this option in order for any changes to be drafted into the Cabinet Paper which is intended to be lodged with the Cabinet Office by 10:00am on Thursday 17 May 2018.

Dasha Leonova

Manager, Overseas Investment, International and Financial Markets

Hon David Parker

Associate Minister of Finance