Forestry investment – a new global asset class?

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PRICEWATERHOUSECOOPERS

Forestry investment – a new global asset class?

Forestry has the potential to become a major new asset class, with attractive 'bond-like' returns. Yet use of an inappropriate tax structure can erode returns.

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Traditionally, forestry as an asset class rarely featured in institutional investment portfolios, although it has always been popular with wealthy individuals. As institutions seek genuine diversification and 'green' investments move up their agenda, however, new markets are developing in the financial sector for investment products which promote sustainability and social responsibility and reduce climate change.

Over the past decade, the US has led the way in structuring timberland investment vehicles. The sell off of forestry assets by many industrial players led to the emergence of Timber Investment Management Organisations (TIMOs), through which Timberland investment has become an established element in a balanced North American investment portfolio.

But what's next? TIMOs can no longer rely on the industrial players as a source of assets. They are now seeking to increase their returns by diversifying their business strategies and exploiting the asset class to ensure the most valuable and best use of forestlands by, for example, maximising their potential for renewable energy sourcing. In addition, as competition increases, the US TIMOs are beginning to shift their investment focus outside of the US to tap into the more attractive returns available in other regions.

International expansion

At the same time European investors are rapidly becoming interested in forestland and we are seeing the beginning of forestry-specific investment funds in Europe. These funds seek to take advantage of the stable returns available from this asset class, while benefiting from favourable local forestry taxation regimes. To date, the southern cone of South America and Australasia have been the main target locations but Asia and Africa are gaining attention. Europe is also attracting increasing interest, despite the barriers created by its traditionally fragmented and state dominated forestland ownership structures.

As well as the emergence of European forestry funds, we expect to see increased activity in forestland preservation as a result of the United Nations' proposed scheme aimed at saving the remaining tropical forestlands. This scheme aims to pay national and local governments to keep their forests intact and preserve the habitat of many species of animal and plant life indigenous to them. The development of the nascent voluntary carbon credit market could be a further key to the future of timberland investment, because if carbon credit markets become established and even mandatory, they could provide an additional source of income from forestland in addition to, or even instead of, the harvesting of the timber.

Tax perspectives

These exciting developments pose many challenges from a tax perspective. Finding a suitable fund structure for multiple classes of investors with contrasting. and sometimes conflicting requirements, is invariably complicated and complex. In addition, the locations of forestland assets means that funds must deal with many countries around the world with far less developed tax and legal regimes than found in Europe and the US. In many countries there are issues with land ownership by overseas investors, and while timber investment typically attracts some form of local tax relief it can be hard to get the benefits of this at fund level.

Investing successfully into global timberland requires knowledge of the interaction of investor requirements for transparency, tax efficiency and good governance, with a good understanding of the underlying forestry investments and the local challenges in each jurisdiction. Timber is a long-term investment and returns can easily be eroded if the wrong structure is used. If structured correctly, however, it can be an excellent diversifier and provider of long term 'bond-like' returns, in addition to supporting the future of the planet by locking in carbon emissions and supporting local communities.

Global Asset Management contacts

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