

OIO update – making the consent process easier for forestry

On 22 October 2018, specific reforms to the Overseas Investment Act 2005 (Act) will take effect. These include important changes to the nature and criteria for consents in relation to forestry interests. We summarise the effect of these changes below and their implications for consents under the Act going forward. Although there were also a number of other implications enacted under the Act, particularly in relation to residential land, this update focuses solely on the new forestry regime.

A key objective of the reform was to bring forestry rights (in addition to residential land) into the regime before the CPTPP was ratified. This brought into focus a fundamental problem with the Act: that the tests for obtaining consent were not fit for purpose for forestry investment. The result is a new simplified forestry test, applying to freehold and leasehold interests in addition to forestry rights, aimed at enabling and encouraging ongoing overseas investment in the forestry sector. There is also an option to obtain a standing consent, which enables an overseas investor to enter into multiple forestry transactions without obtaining consent on each occasion (subject to conditions and reporting requirements).

Context

The forestry sector makes important contributions to the New Zealand economy. Among other things, forestry:

- accounts for ~3% of GDP and is one of the country's largest export earners;
- is reliant on direct overseas investment. It is estimated that overseas investment accounts for more than 70% of the investment in the sector. As a long term investment – security of tenure and expectations of liquidity are crucial;
- provides significant employment and investment in New Zealand's regions; and
- is a cornerstone of the Government's 1 billion trees and climate change policies.

Typical owners in the asset class are offshore Timber Investment Management Organisations (**TIMOs**) backed by pension and sovereign wealth funds with long term capital, reflecting that single rotations of timber stands typically exceed 25 years.

Under the status quo, an investment in forestry is treated much like any other overseas investment under the Act. Freehold and leasehold interests almost certainly constitute "sensitive land". The acquirer is therefore subject to the **counterfactual test** requiring it to demonstrate that a substantial and identifiable benefit will result from the acquisition when compared to the counterfactual (usually a New Zealand purchaser or the existing owner continuing in ownership). Benefit analysis is weighted towards the domestic processing of primary products. These benefits can be difficult to demonstrate, particularly in the context of a sale by one overseas TIMO to another.

The enacted reforms recognise the importance of the forestry as an asset class for investment and seek to establish a more streamlined consent process, with the intention of promoting investment and liquidity in these assets.

Summary of status quo and reforms

The table below summarises the effect of the changes at a high level:

	STATUS QUO	EFFECT OF REFORMS
FORESTRY RIGHTS	<p>Forestry rights are not an interest in land and fall outside the "sensitive land" consent regime. Consent is only required where the value of the forestry rights exceeds the \$100m "significant business assets" threshold. Such a consent focuses on the investor test.</p>	<p>The acquisition of forestry rights with a term of at least three years in excess of 1,000 ha in a calendar year is an acquisition of an interest in sensitive land. These may be acquired under the special forestry test discussed below.</p>
FREEHOLD AND LEASEHOLD INTERESTS	<p>Freehold interests and leasehold interests with a (remaining) in excess of three years that exceed 5ha (or any lower threshold) – either separately or together with any "associated land" – are interests in "sensitive land". An acquisition by an overseas person of such interests requires consent under the Act decided by the relevant Minister.</p> <p>In addition to satisfying the investor test, the applicant will also need to demonstrate substantial and identifiable benefit to New Zealand. The benefit to New Zealand is assessed against 28 factors in the Act and Regulations (benefits factors). This benefit needs to be incremental over and above the counterfactual position for the investment.</p>	<p>The acquisition of such freehold and leasehold interests continues to be treated as an acquisition of an interest in "sensitive land". However, the applicant may take advantage of the following new consent pathways for forestry assets:</p> <p>Special forestry test: A simplified test, which simply requires a commitment to replant and to continue certain existing arrangements.</p> <p>Standing consent: A standing consent which enables future multiple forestry transactions without the need to apply for consent again.</p> <p>In most cases the special benefits test will likely apply, but if not apply either:</p> <p>Modified benefits test: Establish substantial and identifiable benefit to New Zealand but with a counterfactual against no change in ownership (rather than a New Zealand purchaser).</p> <p>Existing benefits test: Establish substantial and identifiable benefit to New Zealand – counterfactual usually against a New Zealand purchaser or existing owner continuing to own.</p>

Forestry rights

Forestry rights are the right to establish, maintain and harvest a crop of trees. Currently they are exempt from the consent, except when the value exceeds the \$100m threshold as an acquisition of significant business assets, in which case consent is generally subject to satisfying the **investor test**, which focuses on criteria relating to the good character, business acumen and financial commitment of the applicant and meeting certain Immigration Act requirements.

The changes brought in by the reforms see forestry rights with a term of at least three years falling within the regime as interests in "sensitive land", subject to a 1,000 ha threshold. This threshold applies across separate investments occurring in any one calendar year. Acquisitions by "associated persons" are also aggregated. An overseas person will require OIO consent for any transaction, which will take them over this limit.

Important exceptions to the consent requirement include the renewal of pre-existing rights on substantially the same terms, or taking Crown forestry licenses, which are **not** otherwise interests in land.

Consent pathways

The reforms introduce important new consent requirements for forestry.

In all cases, the applicant will need to meet the investor test but will be able to opt for one of the alternative pathways set out below. The special forestry test provides the easiest path and should be able to be applied in most cases.

Special forestry test

An investor must establish the criteria for the special benefits test in relation to a standing consent and may also take this approach for a specific consent.

The key requirements to establish this test are as follows:

- The relevant land must be acquired for use exclusively for forestry purposes.
- The acquisition may not include any residential land or land which is intended/likely to be used for residential land in the future, except where the use is incidental in connection with the forestry activity.
- Following harvest, a new crop of trees must be established, if the applicant's rights allow replanting to occur.
- The applicant must maintain any existing contractual commitments to provide logs to domestic processors.
- The applicant must maintain any commitments to historical heritage sites, biodiversity, the environment and public access.

Importantly, the Minister (or OIO under delegation) can decide not to apply one of the requirements if satisfied that the overseas investor will not have sufficient ownership or control of rights in respect of the land to ensure that the requirement will be met. For example, an investor purchasing a forestry right with no right of renewal that would enable replanting, could ask that that requirement not apply and proceed under the special forestry test.

Standing consent

Unique to the overall regime is the ability for an investor to seek and obtain a standing consent to future forestry investments, not yet entered into.

The consent can only be relied on where the special forestry test (see above) will be satisfied by that investment.

The key criterion for obtaining a standing consent is a demonstrated history of obtaining and complying with OIO consents or the equivalents in foreign jurisdictions. It is unclear at this stage what the OIO will require, but it is expected that they will expect to see evidence of conditions that have become live and have been reported on. OIO, forms and guidance are expected to be released shortly.

The Minister must also be satisfied that the special forestry test conditions are likely to be met and that the overseas person has processes in place to ensure the conditions will be met. As noted above, the conditions are that the overseas investor commits to continuing existing arrangements (as defined in regulations which accompany the reforms).

A waiver of the requirement to replant can be included in the standing consent for any forestry rights which expire upon harvesting or shortly after harvesting.

Once obtained, if the investor wishes to make an investment in reliance on their standing consent, they must self-assess the investment against the special forestry test and report to the OIO. The standing consent will include conditions that set out when and how the reporting must be done and what information must be provided about how requirements will be met.

The OIO has a broad discretion in relation to conditions it wishes to impose and can require property to be disposed of if conditions are breached.

There are also mechanics in the Act permitting the OIO to vary the conditions and scope of the consent. The investor may also request that the OIO vary the consent in circumstances where, due to the investor not having a sufficient ownership or control over the land after the investment, the investor is unable to ensure compliance with requirements that it plant new trees to replace harvested trees, or any other requirements in regulations.

Other options

The "modified benefit test"

This consent pathway essentially imposes the requirement to demonstrate substantial and identifiable benefit to New Zealand against the statutory and regulatory criteria – but with a counterfactual against the current owner continuing to own the land. This could be used for transactions where the requirements for the special benefits test cannot be met.

The "existing benefits test"

This preserves the option to apply the traditional consent criteria – showing a substantial and identifiable incremental benefit to New Zealand counterfactual, which

could include comparison against a well-funded New Zealand investor acquiring the land. This is likely to be relevant in circumstances where the acquisition transaction goes beyond just forestry assets and includes other sensitive land.

Summary and comment

The reforms were subject to significant dissent from opposition parties, including on the grounds of already very significant foreign ownership within the asset class. Criticism was also levied against the sector specific focus without any corresponding accommodations in other primary industries such as viticulture.

However, we see the changes as very positive and should, in our view, reduce the economic inefficiencies that can manifest under the traditional consent criteria when applied to forestry. It remains to be seen as to how extensive standing consents granted by the OIO will be. We would hope that these provide broad abilities for consent holders to undertake acquisitions in line with the overall aim of streamlining the transaction process and liquidity within the asset class.

Consent timeframes will also be important and we understand that the OIO is in the process of separating resource to provide attention to applications in relation to forestry and residential land.

The standing consent process and special benefit criteria are clearly designed to further speed up and simplify the consent process for landowners and investors. In our view, standing consents are likely to recalibrate sale dynamics for forestry assets as investors with standing consents likely to be favoured in any competitive bidding processes. In this regard, we think that it will be important that the OIO can evaluate other transaction specific applications under the special benefits test in particular in a prompt and efficient manner to preserve opportunities for those investors.

The Minister is required to review the operation and effectiveness of the changes as they concern forestry within two years of commencement and report to Parliament.

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