

Chapter A6 – FUNDING AND OWNERSHIP STRUCTURE

Revision History

Original Standard Released in May 1999

Revision in August 2023 Main changes are:

- Changing from the assumption that valuation is based on pre-leverage cashflows to a view that funding and company structural issues should appear in forest market valuation to the extent necessary to improve the estimation process.



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Introduction

Some forests, especially smaller ones, are funded with 100% equity, but most larger forests are funded through borrowings of various types. The ratio of borrowed to equity funds employed ('leverage') can and does vary from nil (100% equity) to, in theory, 100% levered. In practice, thin capitalization rules may put an upper limit on debt for companies controlled by non-residents. Equity investors will typically leverage their funding to increase the profit to the equity investment or to shift or minimise the burden of taxation.

The funding (and taxation) arrangements surrounding a forest are often reflected in its ownership structure. For example, a forest investment may be undertaken by a company having existing tax losses with the funding provided on demand as borrowings from its overseas parent. Structural arrangements are often exceedingly complex and cross national boundaries.

The major source of wealth in a forest ownership system is the interaction of trees, land, carbon, capital and management. The burden of taxation on the forest can be considered to be a distribution of part of that value to the State. Leverage can be considered the distribution of wealth to the lenders. Structural arrangements can be considered the mechanisms to shift subsidies, profits, risks, liabilities and taxation burdens between entities that each have a call on the wealth within the system. The wealth generated by the forest plus any subsidy, is the total of wealth available for distribution within the forest system.

Entities

The process of adjusting an unlevered forest valuation to one with added leverage and structure is complex. A wide range of funding and structures potentially exist. At one end of this range is the cashflow of a forest investment wholly funded with equity. At the other end is the cashflow of an entity with loan or promissory note draw downs and repayments, interest, imputed tax loss benefits, exercise of contingent rights and all other aspects of modern financing.

Forests certainly are funded by borrowings and structured into company groups. The corporate segment of the market will compete for forest assets against those who adopt more simple funding sources and structures. The benefits and costs of funding and ownership structure are notionally contained in the market price, and hence incorporated in either;

- a comparative sales analysis; or
- inferred in the discount rate if using the income approach.

To include funding and ownership structure in a valuation model?

These standards take the approach that funding and company structural issues should appear in forest market valuation to the extent necessary to improve the estimation process.

The note at the end of Chapter A5 about the inclusion of taxation in discounted cash flow models also applies to the inclusion of complex funding and ownership structures. If doing so helps explain variation in observed transaction evidence then there is some justification for their inclusion. Otherwise, a simple model may suffice.



**Important caution
to forest valuers**

The caution at the end of Chapter A5 about the role of the forest valuer also applies to the provision of advice on funding and ownership structure. Forest valuers are typically not qualified to give competent advice on this topic to clients. This is not to say that a forest valuer cannot effectively assist other professionals in the development of funding and other structures for forest owning entities and analyse their value to the proprietor.

