PLANTATION INSURANCE: AN INTRODUCTION

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Introduction

Insurance questions that keep coming up in discussions with private forest growers include: whether to insure, why, with whom, how to value the forest, how much to pay, how much to self-insure, and what to insure against.

This paper doesn’t address each of these specifically. Rather, it offers a more general introductory discussion about forestry insurance, with illustrations from the Australian Forest Growers (AFG) group insurance scheme, from which some answers and perhaps some other questions should emerge.

With permission, the paper uses numerous articles in Australian Forest Grower magazine in the Spring editions of 1991 and 1993-95, written by Michael Hall, Ian Wildy and Francis Clarke (AFG), and John Kelly and Murray Turner from AFG’s insurance brokers, IARM and Jardines respectively. It also draws upon the excellent 1998 RIRDC report by Jason Alexandra and Michael Hall, Creating a viable farm forestry industry in Australia. What will it take?

The paper focuses only on plantations (or 'planted forests'), which, for the purpose of discussing insurance, can include plantings for farm forestry/agroforestry. Insurance of managed stands of natural regrowth on private farmland is not discussed.

It is appropriate to begin with a description of the AFG group scheme. Simply describing the scheme itself may answer some questions.

Forest insurance is a specialised service offered by only a few insurers. The insurance market is cyclical. When there is surplus underwriting capacity, insurance is easy to obtain and rates fall. At other times, insurers withdraw capacity, and premiums rise. The effects of this market cycle can be exaggerated by the fact of there being so few insurers.

In such a climate, choosing a forest insurer can be risky, unless a grower is choosing a well-established scheme with a reputable underwriter of longstanding.

Australian Forest Growers Plantation Insurance Scheme

Australian Forest Growers Plantation Insurance Scheme is operated on behalf of AFG by endorsed brokers in Australia, who arrange for the Scheme to be underwritten by Lloyds of London.

The same syndicate from Lloyds of London has been lead underwriter for the Australian Forest Growers Plantation Insurance Scheme since it was established in 1984. During that time, although premium rates have moved with the market, the capacity of the underwriter has always been secure. AFG members who have insured continuously with the Scheme have enjoyed substantial discounts below the rates available in the general market.
With the AFG Plantation Insurance Scheme, if there’s a catastrophic loss (such as the windstorm damage in Tumbarumba in 1998), growers can be sure that their claims will be paid, and that insurance will still be available next season at a competitive rate. The AFG Plantation Insurance Scheme provides security and confidence, at affordable rates, year after year.

The main features of the AFG Plantation Insurance Scheme are:

- coverage;
- agreed value policy;
- qualification for acceptance
- no-claim bonus and continuity discount;
- extensions and public liability;
- plantation loss limit;
- salvage and replanting; and
- deductibles.

**Coverage**

A plantation can be insured for total and partial loss as a result of fire, lightning, hail, windstorm, cyclone and aircraft damage. Disease is not an insurable risk.

**Agreed value policy**

The value of the plantation is agreed at the time the cover is placed, depending upon species, age, location, condition and management. In the event of a loss, the plantation owner is paid the agreed value.

Recommended valuation tables are available for *Pinus radiata* and *Eucalyptus globulus*, and are published in the insurance proposals by the brokers. The valuations are prepared by an independent national firm of consulting foresters and endorsed by Australian Forest Growers. Valuations in the range of high, medium and low are available in most states.

Members have the right to submit different valuations for particular circumstances or other species for the underwriter’s acceptance.

For example, in some circumstances firebreaks, for sound reasons, may not comply with the prescribed standards, and the brokers will make a special submission to the underwriter for acceptance. Such submissions are only required once per plantation, and are a means of keeping the scheme's rates as low as possible. The alternative is to ask the underwriter to accept any plantation regardless of condition, which would lead to higher rates for all growers.

**Qualification for acceptance**

A plantation is automatically accepted for insurance at the rates current for the Scheme subject to a period of qualifying membership of Australian Forest Growers, provided the plantation meets the requirements for management and firebreaks.

There are set dates each year by which a commitment to insure must be made. (When the weather report indicates extreme fire danger and when the local news is reporting deliberately lit fires in your area, it's too late!)
**No claim bonus and continuity discount**

The Scheme currently provides a discount of 3% per year for each consecutive year of renewal, up to a maximum of 21% after 7 years. A further discount of 3% per year for each claim-free year (up to 21% after 7 years) is available as a No Claim Bonus. The maximum combined discount for continuity and no claims is currently 42%.

**Extensions and public liability**

Public liability cover is available as an extension of the policy. Other optional extensions include: removal of debris, claims preparation costs, and loss mitigation expenses up to a maximum of $100,000.

**Plantation loss limit**

The maximum loss limit on any one plantation is $25 million.

**Salvage and replanting**

Growers have the option of reducing the cost of insurance on older pine trees by insuring ‘net of salvage’. Another option is to insure for the cost of replanting only.

**Deductibles**

A range of ‘deductibles’ (sometimes called ‘excess’) enables growers to choose their own levels of financial risk. The higher the deductible the plantation owner is prepared to accept, the lower the premium will be.

**Who bothers to insure?**

Recognising that plantation trees are valuable, and become more valuable over their lifetime, many private forest growers insure their trees against fire, windstorm and other perils.

Perhaps it would be safer to say 'most private plantation growers and investors who are AFG members'. A large (although decreasing) proportion of such growers/investors are looking for a return on their investment as a one-off superannuation lump sum, and it is these growers whose needs align easily with the group plantation insurance scheme. For these individual growers and family companies, their premiums are currently about 1 per cent of the plantation valuation each year. The premium is lower in areas of lower risk and can be reduced by various deductions over time, as exemplified in the description above.

**Corporate industrial forestry companies** tend to combine their forest/plantation assets with their much bigger industrial assets and arrange their own insurance under a broad corporate policy. In this way they are able to negotiate much lower premiums than even the AFG group scheme can achieve.

**Government-owned plantations** do not take out insurance because government accepts its own risks. This situation may change as government plantations 'privatise', although they may still choose not to insure if they have the capacity for a large well-distributed spread of risk.

The question is sometimes raised that certain agroforestry configurations would not be worth insuring, because of their very low hazard rating (for fire, at least), and/or because of the complexity of doing the valuation (eg of multi-purpose plantings).

In response, Francis Clarke offered a cautionary tale in the Spring 1995 *Australian Forest Grower*, where he described how a carefully controlled burn in appropriate seasonal conditions got away and damaged a high-pruned radiata pine agroforest. His principal conclusion was that pruned agroforests are at least as valuable as plantations (see below), and deserve similar insurance protection.
Valuations for insurance

The valuation method used in AFG's group insurance scheme assumes that growers are considering a superannuation style investment for a lump sum, which differs in principle from a company that is in the business 'in perpetuity' and will automatically replant. But both methods take account of thinnings and returns at clearfelling together with all costs from establishment in current dollar values for the full rotation.

Valuation for the superannuation-style plantation is determined on a cost-of-replacement basis, having regard to the expected income stream and future earnings in the event that the crop is destroyed and replanting is necessary. This valuation underpins the 'agreed value' nature of the AFG policy. AFG produces standard valuations for the major species groups by States. These valuations are published in the insurance proposals by the brokers as a guide to growers in establishing a total value for their plantations, and in estimating their insurance premiums.

For most States, there are three options for the grower to choose from – high, medium, and low. A high value insurance would apply where high site productivity, available markets, high initial costs in genetic stock, non-commercial thinning, pruning on time, etc, would together add up to a relatively high economic value.

By contrast, a low ranking value would be appropriate for a plantation with less than average productivity, some distance from markets, and with low cost silviculture.

The owner is asked to state reasons for selecting a high or low value for his or her plantation.

If a grower is not satisfied with the valuation levels set down by the AFG, the grower is entitled to seek a special valuation for their specific plantation, and the insurance broker will present it to the lead underwriter for acceptance. The new valuation would need to be derived by a suitably qualified forester.

This provision for special valuations opens the way to diverge from the standard and to tailor your insurance, such as may be desirable for different types of intensively-managed high value agroforests.

Salvage potential

Salvage is an uncertain item, difficult to assess in advance and only proven after a fire or other damage has occurred. Brokers, perhaps not surprisingly, recommend that private growers should make no allowance for salvage after loss, and should instead protect their asset to its full potential. John Kelly makes such a case in the Spring 1994 edition of Australian Forest Grower.

Nevertheless, it might be instructive to illustrate how one could approach insuring for salvage at different stages of the plantation's rotation.

With a standard policy, in the event of a loss, the grower would be paid the full insured value, and the insurer would be free to sell any salvaged trees for whatever price was possible.

It is estimated, however, that a radiata pine plantation could be 50% salvagable at 20 years, and 80% at 30 years. The argument goes that even in the case of major fire, you would lose only 20% of a 30 year plantation, and could send the rest to a sawmill.

For the grower, the choice becomes: pay a full premium on the 20 or 30 year plantation (expensive), or pay (say) half the full premium and be prepared to recover the salvage.

The major risk is that, to be salvagable, the trees must be recovered in a short time, which could be a problem if the nearest mills cannot cope with a sudden influx of logs. John Kelly's article (1994) gives several more such risks of choosing to self-insure for salvage.
Concluding remarks on insurance

It can be difficult for an individual grower to obtain forestry insurance cover. Forestry insurance is very specialised, and cover is provided by only a small number of underwriters. Even if an individual grower succeeded in taking out insurance, the premium rates could be very high.

Even with the highly discounted rates available through the AFG Plantation Insurance Scheme, insurance is still a very significant cost for maturing plantation assets, and is one of the biggest costs an individual grower will have over the length of a rotation.

Arthur Lyons et al (Spring 1994 *Australian Forest Grower*) succinctly explained the other forms of ‘insurance’ against fire damage in plantations: firebreaks, grass control, good water supplies, access, burn-offs, and good neighbourly relations.

But well-managed plantations create this form of 'insurance' as a matter of course. The big decision, for at least some growers, is whether to take out a real insurance policy.

Without actually telling growers how to make that decision, one could nevertheless say to them…”Prudent investors usually find a way to protect their valuable assets".