

O c t o b e r 2 0 1 0

Editor

Martin Churchill

BSc (Econ) FCA

Tax Efficient Review

INHERITANCE TAX OFFERING
FIM Sustainable Timber & Energy LP

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RISK WARNINGS

RISK WARNINGS AND DISCLAIMERS

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Your attention is drawn to the following risk warnings which identify some of the risks associated with the investments which are mentioned in the Review:

Fluctuations in Value of-Investments

The value of investments and the income from them can go down as well as up and you may not get back the amount invested.

Suitability

The investments may not be suitable for all investors and you should only invest if you understand the nature of and risks inherent in such investments and, if in doubt, you should seek professional advice before effecting any such investment.

Past performance is not a guide to future performance.

Past performance

Changes in legislation may adversely affect the value of the investments.

Legislation

The levels and the bases of the reliefs from taxation may change in the future. You should seek your own professional advice on the taxation consequences of any investment.

Taxation

ADDITIONAL RISK WARNINGS

Inheritance Tax offerings:

1. An investment in IHT offerings may not be suitable for all investors
 - The value of holdings, including partnership interests and income received from them, may go down as well as up and Investors may not receive back the full amount invested.
 - No guarantee is given that the business undertaken will qualify, or continue to qualify, for business property relief.
 - No guarantees can be given as to the investment performance or the level of return achieved from investments or that the overall objectives of the investee companies will be achieved.
 - An investment in IHT offerings is suitable only for well-informed investors and should be regarded as high risk and longterm in nature. Potential Investors are recommended to seek the advice of a financial adviser authorised under the Financial Services and Markets Act 2000 before applying.
 - No guarantee can be given that HMRC will grant business property relief on the full amount of each investment. Loss of business property relief status could occur if, for example, such a business changes its business activities or is taken over by a quoted company or a company whose business is not a qualifying business for business property relief purposes.
 - The past performance of investments should not be regarded as an indication of the future performance of an investment.
 - There is no certainty that the market price of an investment will fully reflect the underlying net asset value or that Investors will be able to realise their investment or that dividends or profit distributions will be paid. An investment should be seen as a long term investment.
 - The information, including tax rules, contained in this document is based on existing legislation. The tax rules or their interpretation and/or the rates of tax, or other statutory provisions may change during the life of the investment and such changes could be retrospective. The value of the tax reliefs will depend on the individual circumstances of an investor.

IHT RANKING TABLE

IHT offerings targeting capital preservation compared

	IHT offerings targeting capital preservation			
	Downing IHT Income Fund 3	FIM Sustainable Timber & Energy LP	Second Stellar Forestry Fund	Sunstone Outsourcing LLP
Offering type	Unregulated collective investment	Unregulated collective investment	Unregulated collective investment	Unregulated collective investment
Structure	English Limited Liability Partnership	Limited Partnership	Limited Partnership	English Limited Liability Partnership
Life of structure		Final termination in 2031 75% majority vote in 2021 & 2026 to continue	Continuation vote after 31 December 2019	Unlimited
Target distributions	4% per annum paid bi-annually	3% p.a. annually	None intended	Minimum base rate plus 0.25%
Upside	Upside small on medium term (average 5 years) investments	Timber & Energy Prices	Timber & Energy Prices	Limited
Downside protection	Diverse trading businesses, each of which should be underpinned by substantial assets. Examples are hotels, health clubs, care homes, pubs, children's nurseries and land for development	Asset backed in land and growing timber. Main risks fire and windblow insured.	Portfolio of freehold land assets with crops	Contracted revenues
IHT FUM	£15m	£25.4m	£4m	£10m
Withdrawals	Annual liquidity in January with the option of 50% liquidity after two months' notice	Sell Shares	Matched bargain basis through Stellar	Twice a year with 6 months notice
Initial Fee/Commission	5.5% initial cost with 2% commission, plus annual trail of 0.5% trail (expenses capped at 3% per annum)	See table in individual reviews		5% initial cost plus 2.5% commission
Annual Management Charge	1.8%			The annual Operator fee is 1%+VAT. The Operator is only paid this fee after investors receive the minimum return of base rate + 0.25%.
Annual operating fee	£25,000			capped at 0.5% of net asset value per annum
Dealing fee -in	1%			
Exit fee	Nil			4%+VAT
Performance fee	20% of total return above initial offer price plus 4p per unit per year			None

Tax Efficient Review rating

	IHT offerings targeting capital preservation			
	Downing IHT Income Fund 3	FIM Sustainable Timber & Energy LP	Second Stellar Forestry Fund	Sunstone Outsourcing LLP
Fund Objectives/ Business Model	34/40	34/40	33/40	30/40
Management Team	26/30	25/30	23/30	24/30
Deal Flow/Exit	17/20	16/20	15/20	15/20
Costs	8/10	8/10	7/10	8/10
TOTAL	85/100	83/100	78/100	77/100

FIM Sustainable Timber & Energy LP	Business Existing Size	Limited Partnership investing in UK commercial forestry £25.4 million (as at end September 2010)
	New fund raise target	£20 million
	Sponsor & Operator	FIM Services Limited
	Forestry Manager	Approved Independent Woodland Managers
	Administrator	FIM Services Limited
	Minimum investment	£28,750
	Commission	3% initial, or equivalent trail
	Available tax years	Closing Date 29 October 2010
	Target return	3% planned distribution from 2012
	Income	
	Overall Forests	6% IRR tax free
	Overall Renewables	12% IRR

Strategy FIM Sustainable Timber & Energy LP (ST&ELP) is one of two forestry offerings in the market at present, the other one being the First Stellar Forestry Fund which is also reviewed in this issue.

FIM aim to provide forestry investors with large scale funds which provide the benefits of diversification, through a broad range of maturity and location. Larger funds might also provide greater liquidity. For example, FIM Forest Fund I LP which was closed for new investment in 2009, has a capitalisation of about £27 million. Turnover to date in partnership interests is £776,830, in 20 separate transactions, which were placed on an average timescale of 42 days and achieved a weighted premium to Net Asset Value (NAV) of 6.2% (Source: FIM).

The ST&ELP currently owns 8,659 hectares, 51 forests in the UK. The objective of the fund raising is to expand the portfolio of UK forests at a time when timber prices are rising from historically low levels and when the Forestry Commission is selling forests particularly in Scotland. Funding will also provide finance to add value by developing additional sustainable renewable energy income streams. The Majority of funds will be invested in further forests with a maximum of up to 1% NAV allocated to risk capital for development and up to a maximum of 15% NAV in renewable energy projects. Gearing is limited to 20% NAV.

The manager has a target internal rate of return of 6% tax free for forest properties assuming 2.5% inflation on all costs and values and on constant timber prices over a 20 year cycle 50% above current prices, which are still 60% below the 1995 peak in real terms. Equity investments in renewable energy projects will have a minimum IRR of 12%. The Manager aims to add value and enhance returns through leases for wind farms, developing small scale energy projects (wind/hydro) through the recently announced Feed-in Tariffs (FITs) which provide index linked prices for 20 years. The Manager also sees opportunities to enhance returns through using the Funds substantial timber portfolio to supply biomass to energy plants in exchange for a premium price or equity share.

ST&ELP is a limited partnership within the definition of the Limited Partnership Act 1907, which provides that investors are taxed according to their own circumstances and liability is limited to investors capital contribution.

The broad range of timber maturity within the core portfolio provides the potential for regular distributions to investors. FIM Sustainable Timber & Energy LP is capable of providing tax free distributions of 3% per annum from 2012, albeit the distributions are dependent on harvest income and cannot therefore be guaranteed.

Commercial forests in the UK tend to be stocked with Sitka Spruce, which produces the largest volume of timber in the shortest time. In addition, the timber has the greatest diversity of end uses. Whilst this species varies in value increment at different stages of its life, the fund manager's financial model allows for present values

to be accurately assessed across a broad range of maturity, from planting schemes with their associated grants, to fully mature trees. FIM see particular value in later stage plantations, which have the potential to benefit from an early rebasing of timber values as biomass energy conversion, a substantial new market for timber, competes with a recovery in the house construction sector.

In addition to the predictable volume growth of the trees, FIM will seek further value by investing funds in higher value land uses, such as energy conversion.

Track record FIM has reviewed the performance of six of the trusts (90% of LP value) being amalgamated into the LP with independent valuations. The other two trusts were specifically formed to develop forests on agricultural land with the benefit of income tax relief and are not relevant comparables.

The performance is based on gross investment, distributions received and the transfer value of the Trust on entry into the LP in May 2010. The return is stated as an Internal Rate of Return. It is stated net of all fees and costs and all expenditure incurred in the portfolio.

FIM returns			
Trust	Start Date	Capital Invested (£)	IRR
FIM Forest Distribution Trust	2000	1,326,000	7.7%
FIM Forest Growth & Distribution Trust	2001	1,138,000	10.3%
FIM Forest Asset Fund	2002	605,000	13.4%
FIM Timber Growth Fund	2003	2,500,000	8.7%
FIM Timber Growth Fund II	2004	3,081,000	15.4%
FIM Timber Growth Fund III	2005	3,380,000	4.7%
Weighted average			9.0%
Source: FIM			

In comparison, the Investment Property Databank ("IPD") maintains and publishes the IPD Forestry Index (www.ipdglobal.com), generally accepted as a benchmark for UK forestry performance.

The IPD UK Forestry Index is calculated from a sample of private sector coniferous plantations of predominantly Sitka spruce in mainland Britain. FIM contributes information to IPD to be included in the sample.

The IPD returns are summarised as:

IPD returns		
Duration	Period	Annualised Total Return p.a
10 years	2000 – 2009	8.1%
5 years	2005 – 2009	16.6%
3 years	2007 – 2009	16.1%
Source: IPD		

It is emphasised that the IPD UK Forestry Index excludes purchase and fund raising costs and portfolio management fees from the calculation of returns, the inclusion of which would reduce the returns stated.

Tax Efficient Review Fund Objectives/ Business Model rating: 34 out of 40

Manager FIM is a long established business formed in 1979 with expertise in acquiring and managing rural land based investments. FIM manages over 55,000 hectares of land, ranging from individual portfolios to structured investment products, with a value of some £200m.

FIM has extensive experience in promoting and operating UCIS across a range of businesses including land, property, forestry and windfarms.

The FIM fund management team comprise:

Richard Crosbie Dawson (Managing Director) - a qualified member of the Royal Institution of Chartered Surveyors, who has guided the expansion of FIM over the past 25 years to include the wide range of services and expertise now incorporated into the Renewables Division. Expertise extends to dealing with all property matters, including complex documentation and due diligence matters, devising and implementing investment schemes particularly those based on tax efficient structures and a wide range of investor contacts established through FIM's investment business. Registered adviser with the Financial Services Authority.

Colin Lees-Millais FRICS (Director) - Chartered Surveyor with particular expertise in forestry and agricultural business. He is responsible for acquisitions and investment business. Registered adviser with the Financial Services Authority.

Robert Daniell (Consultant) - primary focus is FIM's renewables business and structured forestry investment products. Robert worked in wholesale and investment banking as a Managing Director for ABN Amro, prior to that, Chase and J P Morgan. Robert then worked for Rescap, the mortgage arm of GMAC, as Managing Director, member of the Executive Committee and a non-executive Director of their UK business. Robert has an MBA from the London Business School and a BSc (Hons) in Forestry from Aberdeen.

Edward Goldsworthy (Corporate Finance Executive) - joined FIM in November 2009 as a corporate finance executive to work on the origination, assessment and management of renewable energy and forestry investments. Prior to joining FIM Ed trained as an ACA with KPMG before moving into commercial finance with Siemens L&A and then corporate finance with MacIntyre Hudson LLP where he specialized in business start-ups and mid-market transactions.

Joshua Oakley (Fund Manager) - joined FIM in October 2009 from the Ventus Funds (managed by Climate Change Capital). He is responsible for the preparation of financial models and the identification and analysis of potential investments in the sustainable forestry and renewable energy sectors.

David Reid AssocRICS (Fund Manager) - joined FIM in May 2010 from Savills where he trained as a surveyor and specialised in valuation and rural property management. He is in the final stages of completing an MSc in Real Estate Investment and Development and joined FIM on account of his interest in property investment.

Tax Efficient Review Management Team rating: 25 out of 30

Deal flow Forestry is usually considered to be a long term investment. The costs of acquiring forests, mainly in terms of stamp duty land tax, make it difficult to produce strong returns in a short period without real timber price rises or strong inflation.

The initial termination date is May 2021. The fund can be extended for two five year periods, subject to a majority of 75% in favour of continuing. There is a final termination date of May 2031.

Exit Interim liquidity is provided by FIM matching buyers and sellers. Since March 2008 and June 2010 FIM have placed approximately £2.9 million of transfers in 60 transactions the funds it operates with a weighted average premium of 1.6% to NAV. In addition the LP can buy in up to 25% of Partnership Shares.

FIM will be appointed under a management agreement which can be terminated if

Table 1: Fee and Cost Comparison

Source: Information Memorandums

	The Second Stellar Forestry LP	FIM Sustainable Timber & Energy LP
1. Front End Fees		
Fund Raising	2%	3%
Property Acquisition	2%	
IFA Fee	3%	3%
IFA Carry of 0.25% p.a. NPV over 10 years @ 8%	1.7%	No IFA carry
Total Front End Fees	8.7%	6.0%
Costs associated with Fund Raising	£40,000	£25,000 (capped)
2. Annual Management Charges		
Woodland and Investment	10% of IPD Annualised total return	0.5% Investment Management
Management Fee	Last 10 years IPD total return 8.1% 0.81 (8.1% x 10%)	0.3% Woodland Management
Annual Management Fee	0.81%	0.80%
3. Realisation/Placing Fees		
Realisation Fee	2%	2%
Placing Shares	Up to 5% (unless waived)	3%
Independent Valuation	No	Yes Every fourth year
4. Performance Fee		
	25% of any excess of IPD Index Return	15% above preferred pretax return of 7% p.a. on equity invested net of distributions
5. Fund Characteristics and Size		
Distribution	None	3% p.a. From May 2012
Duration	10 years years. Shareholder vote to continue on 75% majority	10 years. Shareholder vote to continue on 75% majority.
Current Size	£2m	£22m
Minimum:	£0.5m	None
Maximum:	£5m	£42m
Maximum Fundraising:	£5m	£20m
Minimum Subscription:	£15,000	£28,750

the company provides an unsatisfactory level of service to the members. An advisory committee, drawn from members, will provide input on such matters as conflicts of interest, acquisitions and disposals and any planned changes to the distribution profile.

Tax Efficient Review Deal Flow and Exit rating: 16 out of 20

Costs Initial charges are 6% of the funds raised under the offer. From this an amount of up to 3% of funds raised may be made available to pay introductory commission to authorised intermediaries, whether as a single payment or trail of equivalent value.

The annual management fee payable to the manager is 0.5% of funds under management. An incentive fee is payable to the manager based on 15% of returns in excess the preferred pre-tax return to investors of 7.0% per annum on equity invested net of distributions received. The hurdle rate is significantly higher than the annualised long term performance as measured by the IPD Forestry Index. This means that the management team's interest is aligned with those of the investors.

FIM receive a fee for negotiating income or capital receipts under option for lease agreements or leases with developers of renewable energy projects.

Woodland managers are appointed by FIM at rates which are market competitive. FIM consider that it is essential for the fund manager to operate independently from the woodland manager as the priorities of the investor, which are to maximise timber price and thus the overall return, are not necessarily allied with the woodland manager.

Tax Efficient Review Cost rating: 8 out of 10

Conclusion One of two forestry offerings in the market at present, FIM Sustainable Timber & Energy LP (ST&ELP) is aiming to provide forestry investors with large scale funds which should provide the benefits of diversification, through a broad range of maturity and location.

The ST&ELP currently owns 8,659 hectares spread over 51 forests in the UK. The objective of the fund raising is to expand the portfolio of UK forests at a time when timber prices are rising from historically low levels and when the Forestry Commission is selling forests, particularly in Scotland.

As with all IHT products, this offering carries some tax risk. Rates of tax, tax benefits and allowances are based on current legislation and HM Revenue & Customs practice. These may change from time to time and are not guaranteed.

FIM are well known in the industry as a long-term player in the forestry area and has built a well-resourced team over the years. Coupled with a respectable track record, we place them first out of the two forestry offerings currently fund raising.

Tax Efficient Review rating: 83 out of 100