

NZKGI Hail Compensation Review 2021

Background

Following the large hail event in Motueka on 26 December 2020, NZKGI has initiated a review of hail compensation. The hail event has resulted in approximately \$21m of loss to growers but there is only \$7m worth of Gold 3 industry hail insurance cover. The hail policy runs until the end of July and as we have some time to go before harvest is completed and the hail risk is over, the Gold 3 Pool is now under-insured in the case of further hail events.

This paper provides some options for how the industry could respond to both the unexpectedly large event in Motueka and future unexpected events.

- Additional pool contribution
- Zespri corporate contribution (shareholders)
- Grower opt-in mechanism - Zespri has flagged that this would be difficult to process, particularly during the Horizon software upgrade
- Other - additional insurance for the remainder of the season is being explored by Zespri however insurance companies are unlikely to want to insure against this.

Following industry discussions this outlines NZKGI's proposal given the magnitude of the situation being beyond the scope of the hail policy.

Current hail policy

The Hail Committee reviews and sets the hail policy for the coming season with approval through NZKGI and IAC. In 2020 the Committee adjusted the Gold hail compensation to 75% from 80% OGR less the 10% deductible volume. This was deemed to adequately compensate growers for hail damage. The Hail Committee considered the impact of previous hail events with the worst case being in 2016 where Gold losses were 0.80% loss of total OGR and payments required were under the \$7m cover. In comparison, to date the hail loss for 2021 is in the region of 2.4% - 3 times the modelled worst case scenario. While the policy was sufficient for previous levels of damage, it is not sufficient to cover the Motueka event.

The Hail Committee looked at the cover from the point of view of covering for on orchard costs and considered that for Gold on orchard costs were on average \$3.13 per tray. However, it was discussed that this excluded licence costs and land value costs and that this was appropriate.

As assessment of the level of hail cover as a proportion of total OGR for Gold, shows this has been gradually reducing over time as Gold production has increased. Hail cover is now consistently less than 1% over the past years due to better returns and higher volumes being covered (Figure 1) companies with Hayward where it has been consistently covered at between 1 -1.5% OGR over the past 5 years as volumes decreased and OGR increased (Figure 2).

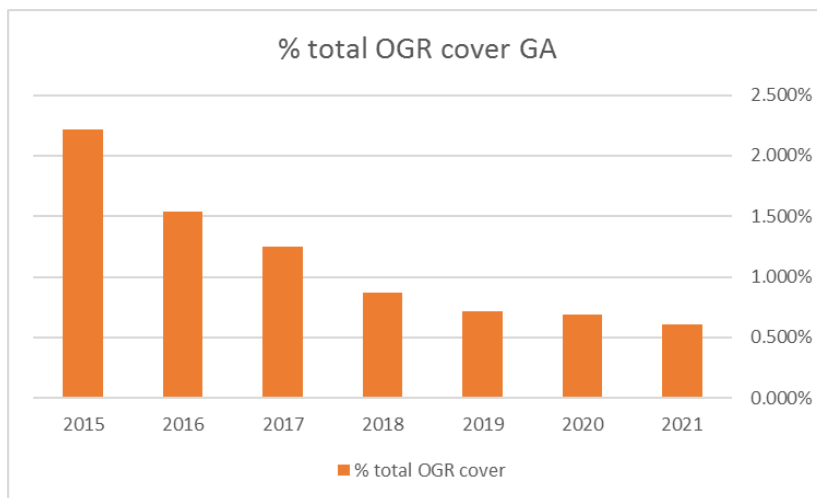


Figure 1 Gold 3 hail cover as a % of total OGR

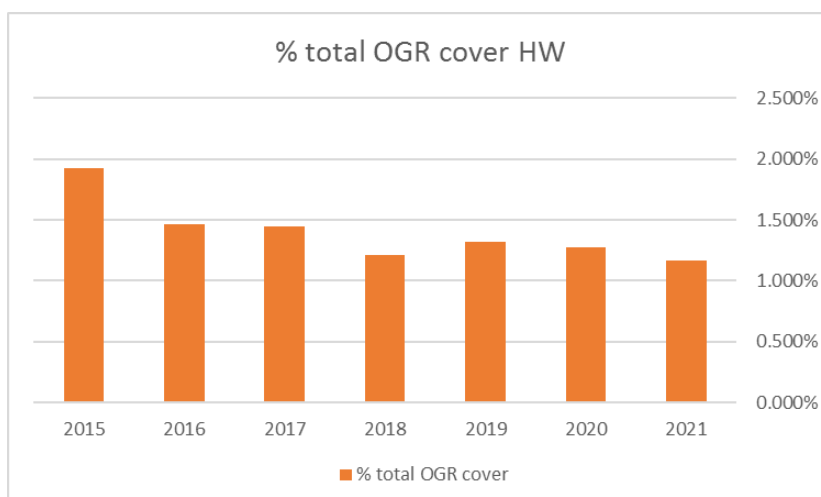


Figure 2 Green hail cover as a % of total OGR

This highlights that perhaps the Gold pool has been underinsured from an OGR cover perspective and should be considered for future seasons.

NZKGI Principles for Pool Compensation

NZKGI has a set of Principles for Pool Compensation agreed by IAC that can be used in events where a grower has incurred unexpected loss.

Principles

Compensation can only be considered where the risk:

- *Was unexpected and beyond reasonable control of the claimant*
- *Could not be mitigated*
- *Was not the fault of the claimant*
- *Could not be realistically insured against*
- *No other support mechanisms (e.g. hail) are in place*

As the compensation is being paid out of growers' funds, the loss for which compensation is being paid out must:

- *Protect the Zespri brand and/or*
- *Protect the consistent quality promise to consumers and/or*
- *Support a New Zealand grower who has suffered an exceptional and unexpected loss beyond the growers control*

Compensation level

- *The level of compensation payable, if any, will be determined on a case by case basis and may only cover fruit production costs or income from fruit sales lost through the event depending on the event.*

Based on the principles of compensation this hail event and further potential hail claims meet the criteria for compensation except where there are other support mechanisms. Arguably the support mechanism currently in place does not currently cover the compensation payable, which is stated to be fruit production costs.

Level of compensation

What is deemed an appropriate level of compensation?

The 2020 hail committee paper states that the average on orchard cost for Gold is approximately \$42,770 per Ha, or \$3.13 per tray. There is a question of whether an orchard that has had a hail strike in December has less on orchard costs than one that is hit in April, however for the purposes of consistency one number should be utilised.

Should licence and land costs be considered as part of on orchard costs?

Based on current claims the cover is around \$3 per TE so not too far below the identified on orchard costs. However, if there are further hail events then this will get further diluted. The table below provides an example if the hail claims increased to 3m trays.

2021 crop	99,500,000	99,500,000
2021 hail claims	2,355,467	3,000,000
Current GA hail cover	\$ 7,000,000	\$ 7,000,000
\$ per TE cover	\$ 2.97	\$ 2.33
Current % OGR cover	25%	19%
Forecast OGR	\$ 12.00	\$ 12.00
Fruit Production Cost	\$ 3.13	\$ 3.13
Excess/ shortfall	-\$0.16	-\$0.80

Table 1 - Comparison of Gold 3 hail cover in case of increase hail claims

Potential options for compensation

Additional commercial hail insurance

There is limited appetite from insurance companies to increase commercial hail insurance for the remainder of the season. Further, the current commercial insurer has signalled their intent not to provide this cover for future years.

Zespri Corporate funding

In 2009 Zespri Corporate contributed \$500,000 into the hail fund on behalf of shareholders. Zespri are yet to provide a view as to whether they would be prepared to contribute to the 2020/21 event.

Pool funding

The pool could provide additional funding to extend the hail cover available for all growers. Current pool funding is \$4m. Given all growers are exposed to under insurance this could partially mitigate the risk.

Grower opt in option

Growers could opt in to provide a higher portion of their OGR to the hail fund as per the 2009 event. This however, requires growers to take an extra action and in 2009 proved that several growers who signalled intent to opt in did not. Zespri has also signalled that this option is challenging and resource heavy to process so a blanket pool option is preferred.

Cost analysis - Gold

The following scenarios have been calculated to understand the cost of topping growers up to the different levels of OGR. It is based on the February OSE, an estimated OGR of \$12/TE for the 2021 season 3 and increase to 3m trays hail affected fruit.

Topping up to 75% of OGR would provide growers \$9/TE for the 90% claimable portion and would cost the pool a total of \$18.2m or \$0.183/TE in the case of no further hail claims or \$24m in the case of 3m TE claims.

Current hail claims - 2.3m trays

2021 crop	99,500,000				
2021 hail claims	2,355,467				
Current GA hail cover	\$ 7,000,000				
\$ per TE cover	\$ 2.97				
Current % OGR cover	25%				
Forecast OGR	\$ 12.00				
Fruit Production Cost	\$ 3.13				
Excess/ shortfall	-\$0.16				
% OGR	75%	50%	40%	30%	25%
Top up required	\$ 6.03	\$ 3.03	\$ 1.83	\$ 0.63	\$ 0.03
per te pool additional cost	\$ 0.143	\$ 0.072	\$ 0.043	\$ 0.015	\$ 0.001
total additional pool cost	\$ 14,199,203	\$ 7,132,802	\$ 4,306,242	\$ 1,479,681	\$ 66,401
Total hail cover	\$ 9.00	\$ 6.00	\$ 4.80	\$ 3.60	\$ 3.00
Total Pool \$	\$ 18,199,203	\$ 11,132,802	\$ 8,306,242	\$ 5,479,681	\$ 4,066,401
Per TE Pool cost	\$ 0.183	\$ 0.112	\$ 0.083	\$ 0.055	\$ 0.041
Total Hail cover	21,199,203	14,132,802	11,306,242	8,479,681	7,066,401
Hail cover/ TE	\$ 0.213	\$ 0.142	\$ 0.114	\$ 0.085	\$ 0.071
% OGR cover	1.78%	1.18%	0.95%	0.71%	0.59%
% Fruit Production Cost	6.81%	4.54%	3.63%	2.72%	2.27%

Table 2 - Analysis of current hail cover and different % OGR cover at current hail claim level

The following table shows the same analysis based on an additional 700,000TE of hail claims.

2021 crop	99,500,000				
2021 hail claims to date	3,000,000				
Current GA hail cover	\$ 7,000,000				
\$ per TE cover	\$ 2.33				
Current % OGR cover	19%				
Forecast OGR	\$ 12.00				
Fruit Production Cost	\$ 3.13				
Excess/ shortfall	-\$0.80				
% OGR	75%	50%	40%	30%	25%
Top up required	\$ 6.67	\$ 3.67	\$ 2.47	\$ 1.27	\$ 0.67
per te pool additional cost	\$ 0.201	\$ 0.111	\$ 0.074	\$ 0.038	\$ 0.020
total additional pool cost	\$ 20,000,000	\$ 11,000,000	\$ 7,400,000	\$ 3,800,000	\$ 2,000,000
Total hail cover	\$ 9.00	\$ 6.00	\$ 4.80	\$ 3.60	\$ 3.00
Total Pool \$	\$ 24,000,000	\$ 15,000,000	\$ 11,400,000	\$ 7,800,000	\$ 6,000,000
Per TE Pool cost	\$ 0.241	\$ 0.151	\$ 0.115	\$ 0.078	\$ 0.060
Total Hail cover	27,000,000	18,000,000	14,400,000	10,800,000	9,000,000
Hail cover/ TE	\$ 0.271	\$ 0.181	\$ 0.145	\$ 0.109	\$ 0.090
% OGR cover	2.26%	1.51%	1.21%	0.90%	0.75%
% Fruit Production Cost	8.67%	5.78%	4.62%	3.47%	2.89%

Table 3 - Analysis of current hail cover and different % OGR cover at 3m tray hail claim level

Had Gold insurance been set to 1% of the total OGR then the compensation would cover the on orchard costs and still would in the case of a further 3m trays of additional hail affected fruit as shown in Table 4. This is something that the hail committee could consider when assessing hail cover in future seasons along with a % hectare cover.

2021 crop	99,500,000	99,500,000
2021 OGR*	\$ 12.00	\$ 12.00
Total OGR \$	\$ 1,194,000,000	\$ 1,194,000,000
2021 hail claims	2,330,000	3,000,000
1% OGR GA hail cover	\$ 11,940,000	\$ 11,940,000
\$ per TE cover	\$ 5.12	\$ 3.98
% OGR cover	43%	33%
Fruit Production Cost	\$ 3.13	\$ 3.13
Excess/ shortfall	\$ 1.99	\$ 0.85
*Note OGR indicative only		

Table 4 - Analysis of Gold 3 cover at 1% OGR

Process

Growers will be asked for their views at the February/ March roadshows as well as through a grower survey. The survey results will be provided for consideration at the March NZKGI Forum where, along with feedback gathered from Forum members, will allow for a recommendation to be formed to take to IAC.

Growers are asked to provide feedback on the following questions:

- 1) The 2020 hail review paper stated the Gold 3 fruit production cost to be \$42,770 per Ha, or \$3.13 per TE. What do you feel is realistic fruit production cost (on orchard costs excluding picking and management)?
- 2) Should the pool provide additional funding to the hail fund to top up 2020/21 hail impacted growers?
- 3) If the so, what level should they be topped up to?
 - a. Fruit production cost only (\$3.13/TE or other value) (additional pool cost \$375,000)
 - b. Fruit production cost plus a premium (\$4.13/TE) as an example (additional pool cost \$3m)
 - c. Increasing the hail cover to 1% of total industry OGR? (additional pool cost \$5m)
 - d. 75% OGR as per the original hail funding mechanism (additional pool cost \$14.2m)
 - e. Other?
- 4) Should Zespri corporate (shareholders) be encouraged to provide funding?
- 5) Should independent grower/post-harvest top up insurance be taken into account?
- 6) How should those with hail nets be treated given they have an 80% rebate on the current policy?
- 7) Do we consider only the 2021 crop impacts or also include impacts on 2022 crop?