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Forestland FRAG-MEN-TA-TION.

Corporate divestitures usher in new class of owners and managers

By Jennifer McCary

Nationwide, about 4.5 million acres of forestland changed ownership in 2003, bringing the total in the last 10 years to more than 11 million, according to resource watchdog organizations. Forest products companies owned about 70% of this acreage and they continue to divest significant forest holdings.

Timber Mart South, a publication that among other things tracks this significant trend, reports that nearly half of the 2003 transactions involved land in the South and that these represented almost twice as many such activities in the region over 2002. Large volume sales have also occurred in the Northeast and Northwest but not at the rate seen in the South.

“It’s a trend that began in the late 1980s and escalated considerably in the latter part of the 1990s,” observes Dick Molpus, President and CEO of Molpus Woodlands Group, a timber investment management group (TIMO) based in Jackson, Miss. Drivers of this shift in ownership include changing corporate strategies, a desire to liquidate timber assets and new market demands.

CHANGING PRIORITIES

In the past, owning and managing huge land bases was considered a necessary expense, just another part of doing business. Timberland was viewed as a resource warehouse-an insurance policy, if you will- that provided low cost logs and fiber for manufacturing facilities.

In Birmingham, Ala., Vaughn Stough of McDonald Investment Co. observes, “ Paper and lumber manufacturers have realized they don’t have to own those timberlands to run their mills. They can purchase stumpage rather than land so they can focus their capital resources on manufacturing and get away from a vertically integrated structure.”

This watershed shift has largely developed in the last decade as foreign competition intensified and the nation’s forest products industry consolidated to remain competitive. Many corporations now view each sector of the operations as stand-alone profit centers that should pay their own way. However, generally accepted accounting procedures (GAAP) artificially undervalued the timber resource at its original decades-old purchase price. Low book values make it difficult to realize the full value of these long-term assets.

“Wall Street analysts punished them pretty heavily for having this asset, “ states Michael Kelly, Executive Vice President of Forest Investment Associates, Atlanta, GA. “The only way to realize that asset is to sell the timberland and reallocate that capital elsewhere. That capital could then be used to expand manufacturing facilities and/or pay down debt accumulated from acquisitions.

Acquisitions typically added forestland as well as manufacturing facilities, meaning that some recent large-scale sales were primarily driven by strategic realignment of physical and real property assets within the consolidating companies.

For example, Weyerhaeuser has been shedding forestland accumulated in acquisitions made in recent years. As of early July the company was in the process of closing the sale of 304,000 acres in Georgia to four purchasers: Virginia Forest Investment LLC, Georgia Fall Line Properties LLC, Southern Timber Consultants LLC and Copper Station Holdings #3. Weyerhaeuser officials say the \$404 million generated will be used primarily to pay down debt. The company in recent years has sold off significant acreage in North Carolina and Tennessee.

Weyerhaeuser communications spokesman Frank Mendizabal states, “Once we had integrated all those (merged) operations, we took a hard look at what fit our need best. We identified operations and timberlands that weren’t such a good fit and either closed or sold those.” CEO Steve Rogel, in an early 2003 interview, said that today’s intensively managed forests are very productive, indicating that fewer acres are required to meet industry’s needs. After the Georgia sale closes, the company’s U.S. timber holdings will be around 6.5 million acres.

In a debt reduction maneuver late last year, MeadWestvaco sold 629,000 acres of its holdings in Maine and New York to Wagner Forest Management LTD.

Beginning in 1995, International Paper acquired Federal Paper Board Co., Union Camp Corp., and Champion International Corp. and has sold several plants and significant acreage. It wants to sell more.

A NEW VIEW

But there has been a fundamental shift in the way some corporations look at timber assets. They no longer are viewed as ‘standing warehouses’ of raw material. Many see them as more of an investment that offers appreciable and relatively stable returns independent of stock market performance. Unlike stocks and bonds, timberland returns aren’t so dependent on the economy. Timberland is a unique investment in that it doesn’t behave like a commodity because trees are living organisms that continue to grow in value exponentially as they mature, no matter what the economy does. Average growth rate alone is about 5% annually.

“That’s a new view for forest products companies as they’ve merged with other companies,” observes Molpus. “In the past, timber was a ‘buy and hold’ proposition.’ With the changing economic climate and merging corporations, timberland is no longer viewed as the underpinning of the company. It’s just one more asset. You can debate whether that’s right or wrong, but that is what’s happening.”

Vertical integration, long the preferred organizational structure of forest products companies, is also being set aside by some corporations as they focus on core businesses, seeking ways to eliminate inefficiencies and shore up competitive strengths in a global market..

Most notable is the 1997 spin-off (The Timber Co.) and ultimate sale in 2001 of Georgia-Pacific’s land base. Plum Creek Timber Corp., which had converted to a real estate investment trust (REIT) in 1999, bought The Timber Co. and its 4.7 million acres. The transaction included a 10-year wood supply agreement. Chairman and CEO Pete Correll stated at the time, ‘Since the separation of our timber business as an operating group in 1997, we have demonstrated that manufacturers don’t have to own timberlands to be competitive.’”

All this teeming timberland activity has gotten the attention of the media, some local and state officials (Georgia wanted some of the Weyerhaeuser land within its borders, but could not come up with the money) and outdoor enthusiasts, particularly hunters, who fear new owners will not be as accommodating regarding leases and/or will increase lease fees.

WHO’S BUYING

About the time industry began to release some of its land base, the demand for timberland investments also grew. Vaughn Stough notes that it’s difficult to determine which trend came first, increasing timber availability or increasing demand for land. Each seems to feed the other.

Some of the demand is connected to routine land trades that have always occurred within the industry. However, the majority has been from buyers outside the industry, primarily from institutional investors such as TIMOs, REITs and other financial institutions.

Between 1995 and 1999, TIMOs and REITs accounted for 60% of all publicly reported timberland transactions in the U.S., according to the Global Institute of Sustainable Forestry. That trend has continued to gain momentum.

“The year 1999 was a reality check for everyone,” says, Molpus. “The volatility of the stock market in the late ‘90s certainly made investors take a second look at timberland assets, even though there had been a organized timber market since the mid- ‘80s.” Suddenly, timberland’s steady returns in the 8-12% range were more attractive.

In the U.S. TIMOs now manage an estimated 12 to 14 million acres, or about 3% of the total 504 million acres of forestland available for commercial timber production. From 1989 to 2002, total timberland investments by pension funds, endowments, universities, insurance companies and wealthy individual investors grew from \$1 billion to \$14.4 billion.

Institutional investors first took notice of timberland investment assets in the mid- '70s when Congress passed the Employee Retirement Income Security Act (ERISA) which encouraged pension funds, endowments and foundations to diversify their portfolios. The California Public Employees Retirement System, CalPER, was among the leading pension funds to invest in timberland in 1988, giving rise to the growth of TIMOs to manage these forests.

There are a dozen or so TIMOs today. John Hancock Timber Resource Group ranks as the largest with more than 3 million acres under management and representing \$2.8 billion in investments worldwide. Resource Management Services (RMS), a 50-year-old land management and consulting firm that managed over a million acres of Hancock lands until late 2003, officially reorganized as a TIMO itself in January 2004.

Two integrated forest products companies recently restructured as a REIT organization to take advantage of tax benefits such as the elimination of double taxation rules that confront traditional C corporations. Plum Creek Timber Corp. converted to a REIT in July 1999; Rayonier Inc. did so last January. Plum Creek owns 8 million acres in the U.S., which represents 83% of its assets. Rayonier owns more than 2 million acres in the U.S. and New Zealand and recently announced plans to purchase another 83,000 acres in Alabama from Great Eastern Timber Co.

STRATEGIES

Both types of groups manage timber as a long term investment, typically in the 10- to 20-year range, which means timberland will rotate in and out of the market, perhaps more than they did as an industry asset. For example, CalPERS has been going through and selling its older timber assets to capture those gains so they can show how well the asset is performing. It reinvests in new timber assets.

Many of the large scale, often non-contiguous timber sales on the market today are being sold to more than one buyer. TIMOs are buying about half of these properties. The other half is typically sold to private investors, some for 100 to 300 acre rural estates and others as Highest and Best Use (HBU) tracts, which may be subdivided or developed as individual home sites. In urban fringes landowners are under tremendous pressure to convert lands to HBU units.

“We’re seeing an unprecedented shift in the pattern of land ownership in some rural areas,” observes Tom Harris, a professor at the Warnell College of Forestry at the University of Georgia and publisher of *Timber Mart-South*. “In the short-term all this movement has put more timber on the market. Long term, the transfer of assets to

smaller and smaller tracts will probably dampen planning rates and intensive forestry practices.”

However, research indicates that investors’ management strategies differ little from the forest industry except that they manage forests as stand-alone investments with no ties to manufacturing facilities. TIMOs and REITs are more likely to follow intense management practices such as reforestation, fertilization and/or pruning to achieve maximum productivity and highest value products. Rotations may also be longer, especially in southern pine plantations, as owners seek higher returns for saw timber products.

One observer suggests REITs will buy more mature timber stands to supply a steady cash flow while TIMOs will invest in younger stands with an eye on the long-term payoff. Another suggests TIMOs will be on the lookout for higher and best use (HBU) opportunities to capitalize their assets.

LOGGER’S PERSPECTIVE

“The good thing about TIMOs from the logger’s perspective,” states Molpus, “is that TIMOs are in the business of growing trees and harvesting timber. They look at their investments with a 15 to 60 year horizon. So they will spend the money to keep the property up and make trees grow. I think it has potential for good relationships for both.” Although some will be managed as HBU land, the overwhelming majority will be used to grow more trees, faster and bigger. That is a positive development for loggers, he asserts.

Nonetheless, some have expressed concern that loggers could see additional costs, for example, in road construction, if new owners fail to maintain the type of forest road infrastructure common to some industry landowners. TIMOs sell most of their stumpage to mills, either through bid sales or through supply agreements, so loggers can’t expect a lot of improvement in their ability to negotiate with wood buyers.

“From the logger’s standpoint, he’s going to see smaller and smaller tracts,” predicts Harris, who anticipates continued ownership fragmentation. “And he’s going to deal with more people, who may not have timber investment as their priority. Their reason for buying the property may be aesthetics or recreation first, with timber production as a second, third or fourth priority.”

MULTIPLE USES

Institutional investors are also more likely to manage for multiple uses such as recreation, wildlife habitat and conservation. They are more receptive than private landowners to partnering with conservation groups to set aside lands or install conservation easements. It’s unclear whether these encumbrances will have a negative impact on the assets’ future value.

Conservation groups such as the Nature Conservancy, The Conservation Fund and the Trust for Public Land have also been purchasers of timberland, usually at the retail level. Observers predict such groups will try to focus on structuring purchases on the wholesale level. Three strategies have been suggested: Continued partnerships with TIMOs, raising equity via some type of timber bond, and/or cooperating with each other to establish a conservation forest fund.

PRICEY PARCELS

While conservation groups are seeking wholesale status, several major corporations are trying to move to the retail level, selling smaller plots instead of large blocks. There is a growing demand among private individuals to own 'their own little corner of the forest.' Several major corporations have spun off separate real estate companies to handle the sale of some of these HBU units.

Weyerhaeuser Real Estate Development (WRED) started marketing mini-tree farms in the greater Seattle area in 2002. Located about 20 miles south of Tacoma and 20 miles east of Olympia the McKenna Forest Reserve is a 4,400 acre development in a tree farm. It is situated in a high demand area that offers a striking view of Mt. Rainer and is relatively convenient to the Pacific Coast. There are six adjacent gated communities, each divided into minimum 20-acre parcels. WRED improved existing logging roads and built a network of trails and community parks.

Except for home sites proper, parcels are classified as forest land for tax purposes and come with a professionally prepared forest management plan and a three-hour consultation with a forester. More than 80% of the parcels have been sold, some for as much as \$250,000. Typically, owners invest up to \$300,000 for dwelling and/or outbuilding construction.

"We have a lot of educational opportunities to help introduce the whole forestry idea," states WRED's Brad Johnson. "People understand the value of land, but they often have trouble understanding the value of trees." Buyers also receive a two year membership in the Washington Farm Assn., which provides educational opportunities for small tree farmers. In addition, the developer periodically offers a series of buyer workshops through the community owners' associations.

Besides preserving much of its timber base in the McKenna project, another advantage to this type of development is that it eliminates the knotty permitting process germane to traditional real estate developments. Since the land remains zoned for forestry, parcel owners only need to secure a building permit from the county.

Interestingly, the property involved likely was once owned by McKenna Lumber Co., which founded a namesake mill town along the Nisqually River in the early years of the 20th century and operated a sawmill and logging camps there until the early '30s. Weyerhaeuser Timber Co. subsequently acquired the McKenna holdings. Weyerhaeuser has also broken up and sold small timberland parcels in the greater Atlanta area.

In the Florida panhandle, St. Joe Co. a decade ago exited the paper manufacturing business and reorganized as a real estate operating company (REOC). The company is actively converting its 800,000 acres to a variety of HBU properties, including recreational ranches and woodlands, planned community retreats called River Camps, preserves, farmsteads and home sites.

ANOTHER ERA

In some ways, today's timber trading activities are reminiscent of a pattern established more than a century ago, when railroads, lumbermen and/or wealthy speculators locked up vast tract of virgin timber as the lumber industry moved east to west. Ultimately depleted of timber, most of these lands were sold—some to the federal government as the genesis of national parks or national forests. Another wave of forestland acquisition occurred as paper companies moves north to south, often buying up old-line lumber companies and/or knitting together holdings from individual owners. Now, it appears, some of their second and third generation descendants are buying portions of what their forebears may have once owned.