

Private Forest Landownership in Washington State

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This paper is part of a series of discussion papers written to provide background information on salient issues identified as important by participants at the *Saving Washington's Working Forest Land Base* forum in November 2004.

Abstract

Part 1: Who Owns Washington's Working Forest Land?

Based on a multitude of data sources, approximately 9.4 million acres of Washington's 22 million acres of forested land are owned by private companies, groups, or individuals. Distinguishing among the different private ownership groups is difficult given the range of qualifications assigned to each group; this has led to numerous data sources with different values for private forest landownership categories. The first section of this paper presents a few of the different data sources, provides estimates for private forest landownership, and proposes a set of distinguishing factors for the Northwest Environmental Forum to use for future discussions and actions. The ownership groups proposed are public and private, industrial and non-industrial, and small and large non-industrial; based on these categories, it is estimated that approximately 2.9 million acres of forest land are owned by industrial forest products companies and 6.5 million acres of forest land are owned by non-industrial groups or individuals. Of the non-industrial lands, approximately 3.3 million acres are owned by large groups, companies, investors, or other entities and the remaining 3.2 million are owned by individuals or other small groups.

Part 2: Which Forest Lands are Experiencing the Greatest Rates of Conversion?

An introduction to trends and potential causes of forest land conversion in Washington and the United States is presented in this section of the paper. In an article in the December 1994 *Journal of Forestry*, John Beuter and Ralph Alig quoted a landowner as saying "With what you have to pay for timberland these days, you can't afford to use it to grow timber." This has become increasingly true as competition for the acquisition of timberland causes investors to push assumptions to the limit and to seek value wherever they can find it. The greatest threat to forest land has moved from overly intense management to developed uses, otherwise known as "Higher and Better Use" or "HBU."

Part 3: How Can Timberland as a Financial Investment Affect Conversion Rates?

An examination of the change in ownership of timberland over the last 20 years and the rise of timberland as an institutional investment class where it was once held largely by forest products companies for its strategic value is presented in the final section of the paper.

I. WHO OWNS WASHINGTON'S WORKING FOREST LAND?

1. The Varied Picture of Washington's Forest Lands

Washington's approximately 22 million acres of forest land (Miles 2005) are managed and owned by a variety of government entities, companies, individuals, and other partnerships and organizations. Roughly 55% of the state's forest land is in western Washington and 45% is in eastern Washington (Table 1). Approximately 43% of forest land is privately owned, while 57% is under public ownership and/or management (Bolsinger et al. 1997, Blatner et al. 2004, Miles 2005, WFPA 2005; Table 1 and Table 2). Of the privately owned land, industrial owners and non-industrial owners own approximately 3 to 5 million acres of forest land each; this large range is due to different definitions used to distinguish industrial from non-industrial owners and the type of data used to calculate these values.

Distinguishing between forest land and non-forest land, private and public, and industrial and non-industrial is pertinent to the discussion of private forest landownership. Not all of Washington's forest land is functioning, or has the potential to function, as a working forest. The US Department of Agriculture's Forest Inventory Analysis (FIA) program office estimates that 80% of Washington's forest land could be classified as timberland (Bolsinger et al. 1997; see Table 2): able to produce more than 20 million cubic board feet per year. Based on FIA data from 1989-1991, the most recent fully inventoried dataset currently available, approximately 17.3 million acres of forest land are classified as timberland.

Other methods of differentiating between forest land and potential working forest land base could be useful; for example, taking into consideration not only growing potential, but overall land base, neighboring land uses, etc.

Public lands are fairly easy to identify; there is some confusion, however, surrounding tribal lands. Approximately 1.5 million acres of Washington's private forest lands are in tribal ownership (WFPA 2005), slightly more than 10% of the total forest land base.

The distinguishing factors between industrial and non-industrial owners are varied: industrial landowners hold more than 5,000 total acres (Rogers 2001), more than 1,000 total acres (WFPA 2005), operate wood using facilities (Bolsinger et al. 1997, WFPA 2005), harvest a minimum amount of board feet per year, and/or are incorporated or are a business entity. In many cases, non-industrial owners are simply the inverse of industrial.

In order to achieve the Northwest Environmental Forum's goal of "saving Washington's working forest land base," consistent ownership information must be agreed upon. Programs and policies must be directed towards specific ownership groups. Without fully understanding the complexity surrounding ownership information, program and policies will not be successfully directed at appropriate ownership groups. Additionally, a common understanding of what characterizes a working forest is necessary. This paper proposes a definition of working forests and a differentiation of ownership categories to further the goals of the Forum participants.

The following map (Figure 1) shows the distribution of public, private, and industrial and non-industrial forest land; the private forest land information presented in the map is the only statewide parcel-level data source currently available, and produced from GIS layers and paper maps of parcels and associated tax status. The designations are based solely on lands classified as commercial or designated forest or timberland by counties' assessors' data and total acreages greater or less than 5,000.

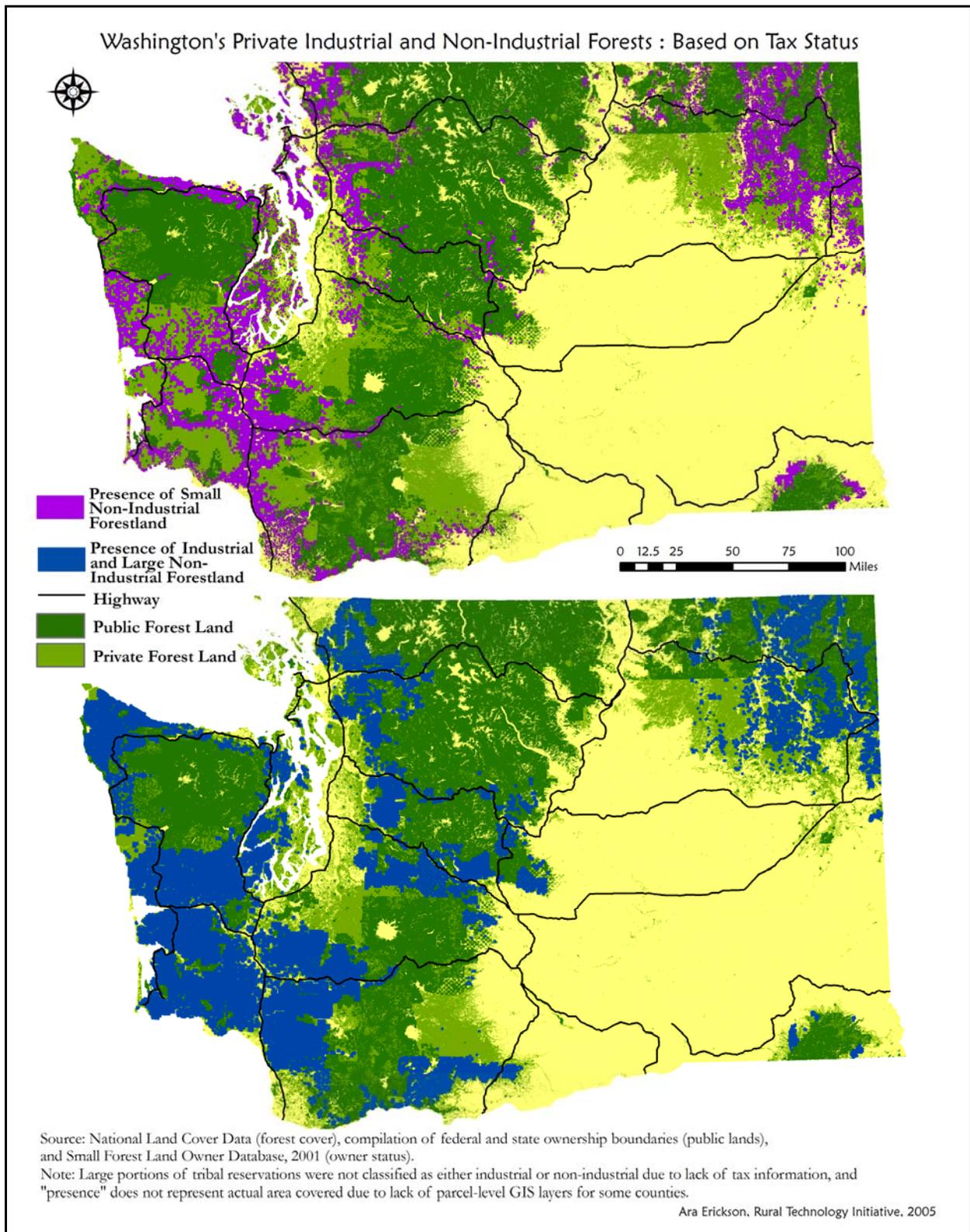


Figure 1. Washington's Forest Land

2. Problem

So many sources of data and so many differing views of ownership categories make for difficult decision-making, and lead to problems with designing policies, actions, and programs aimed at conserving working forest land. Properly defining the goals and objectives of conserving Washington's working forest land is necessary. Additionally, it is nearly impossible to assess conversion rates related to different ownership groups if classifications are defined differently to start with.

3. The Different Pictures of Private Ownership

The following section illustrates just a few examples of the variability in currently available private forest landownership data. Much of the data must be viewed and used with caution; for example, the most recent FIA annual survey for Washington is only 30% complete. The only complete data source is from the early 1990's. Table 1 shows forest landownership according to 2004 FIA data (Miles 2004).

Table 1. Forest Landownership, Forest Inventory Analysis Annual Inventory, 2004

Ownership	Entire State (acres)	Western Washington (acres)	Eastern Washington (acres)
Total	21,981,284	12,215,007	9,766,277
Public	12,574,566	6,857,951	5,716,616
Private	9,406,718	5,357,056	4,049,662

Note: Tribal lands are considered private

Washington State University (WSU) Extension Bulletin *Washington's Forest Products Industry: Current Conditions and Forecast 2004* (Blatner et al. 2004) reports that the state's forest lands total 23 million acres; 14.7 public and 8.3 private. The difference between these reports is likely WSU's inclusion of tribal lands in the public category, as compared to tribal lands being considered private lands in the FIA reported data (Table 1).

The WSU report states that slightly more than half of the private lands are in industrial forest landownership, managed primarily for timber production, and the other half are owned by non-industrial or other private business entities. The Washington Forest Protection Association (WFPA), however, reports in their recent *Forest Facts and Figures* (WFPA 2005), which is based on 2000-2001 FIA interim data and 1997 Resource Planning Act (RPA) Assessment data, that 59% of private land is owned by industrial owners and 41% is owned by non-industrial owners. Once again, the difference in these reported numbers is likely due to a difference in semantics: WSU's definition of industrial owners is that they manage primarily for timber production, while WFPA defines industrial as companies or individuals operating wood-using plants and/or companies or individuals with statewide holding totaling 1,000 or more acres.

Another data source for landownership information is *Washington's Public and Private Forests* (Bolsinger et al 1997), which relied on the 1989-1991 FIA database. The data (Table 2) in this publication was used for the basis of the calculations for the often-referenced Washington Department of Natural Resources' *Our Changing Nature* (Belcher 1988), as well as many other publications that address forest ownership, health, and status.

Table 2. Washington's Public and Private Forests, 1997

Ownership	Forest land		Timberland	
	Acres	Percent	Acres	Percent
Entire State				
Total	20,894,000		16,083,000	
Public	11,148,000	53%	7,129,000	44%
Private	9,746,000	47%	8,954,000	56%
<i>Forest Industry</i>	4,805,000	49% of private land	4,610,000	51% of private land
<i>Other Private</i>	4,941,000	51% of private land	4,344,000	49% of private land
Western Washington				
Western WA total	11,877,000		9,581,000	
Public	6,067,000	51%	3,871,000	40%
Private	5,810,000	49%	5,710,000	60%
<i>Forest Industry</i>	3,785,000	65% of private land	3,732,000	65% of private land
<i>Other Private</i>	2,025,000	35% of private land	1,978,000	35% of private land
Eastern Washington				
Eastern WA total	9,017,000		6,502,000	
Public	5,081,000	56%	3,258,000	50%
Private	3,936,000	44%	3,244,000	50%
<i>Forest Industry</i>	1,020,000	26% of private land	878,000	27% of private land
<i>Other Private</i>	2,916,000	74% of private land	2,366,000	73% of private land
Forest land is defined as land at least 10% stocked by live trees or land formerly having such tree cover and not currently developed for non-forest use. The minimum area recognized is 1 acre. Forest Industry = private land owned by companies that grow timber for industrial use. Includes companies with or without wood processing plants. Other Private = private land not owned by forest industry. Tribal land, farmer-owned land, and miscellaneous private land are included.				

Most would argue that ownership information is much better assessed using parcel-level data rather than point-level data; all of the data presented thus far are based on some variation of the FIA data, either the periodic, interim, or annual data from different years, which comes from fixed points on a 3.4 mile grid across the state. Parcel-level data allows a more complete picture and description of working forest lands and actual ownership patterns, and could answer questions similar to the following: How many people own one parcel of land? How many acres of industrial land are in a certain geographic area? How many parcels make up one large area of contiguous forest?

A Small Forest Landowner Database, created in 2001 for the Washington Department of Natural Resources by the University of Washington, College of Forest Resources' Rural Technology Initiative, was a first attempt at gaining a more precise idea of where small forest landowners live and own land in Washington. This database was built from county parcel data, and assumed that the designation of tax status alone would distinguish forest landowners across the state; rather, many non-industrial forest lands are classified as open space or undeveloped lands rather than designated commercial forest or timberland. Thus, the database produced an estimate that appears far too low for small forest landownership across the state. Further work with the database showed that by including remotely-sensed information to detect forest cover, the actual amount of small forest land owned parcels increased almost two-fold.

Although the 2001 database is limited, it does provide spatial estimates of forest ownership patterns, which are difficult to achieve with FIA points, and actual numbers of owners rather than just area figures. Drawing from this database, it can be estimated that there are approximately 60 large industrial owners (vertically-integrated forest products companies and those who own more than 5,000 acres across the state) and somewhere between 30,000 and 50,000 non-industrial owners (those who own less than 5,000 acres across the state).

4. A Proposed Solution

First, a distinction must be made between working and non-working forest lands: non-working forests could be considered any forest land where forestry operations are specifically prohibited or are smaller than some minimum size, perhaps 1 acre; working forests would be all other forest land. This acreage requirement is subject to further refinement based on contiguity. Working forests operate best when they are surrounded by other working forests. A broader definition of a *forest land use*, rather than forest cover, would be appropriate. Forest land use could be described as large contiguous areas of forested land, perhaps incorporating certain compatible non-forest uses, such as scattered houses, roads, and other open space. Programs could then be targeted at specific locations where forest land use is present, rather than at a lone tract of forest land where the potential for a working forest is slim.

The diagram in Figure 2 depicts a proposed method for distinguishing among the different forest landowner types, as discussed in the following paragraphs.

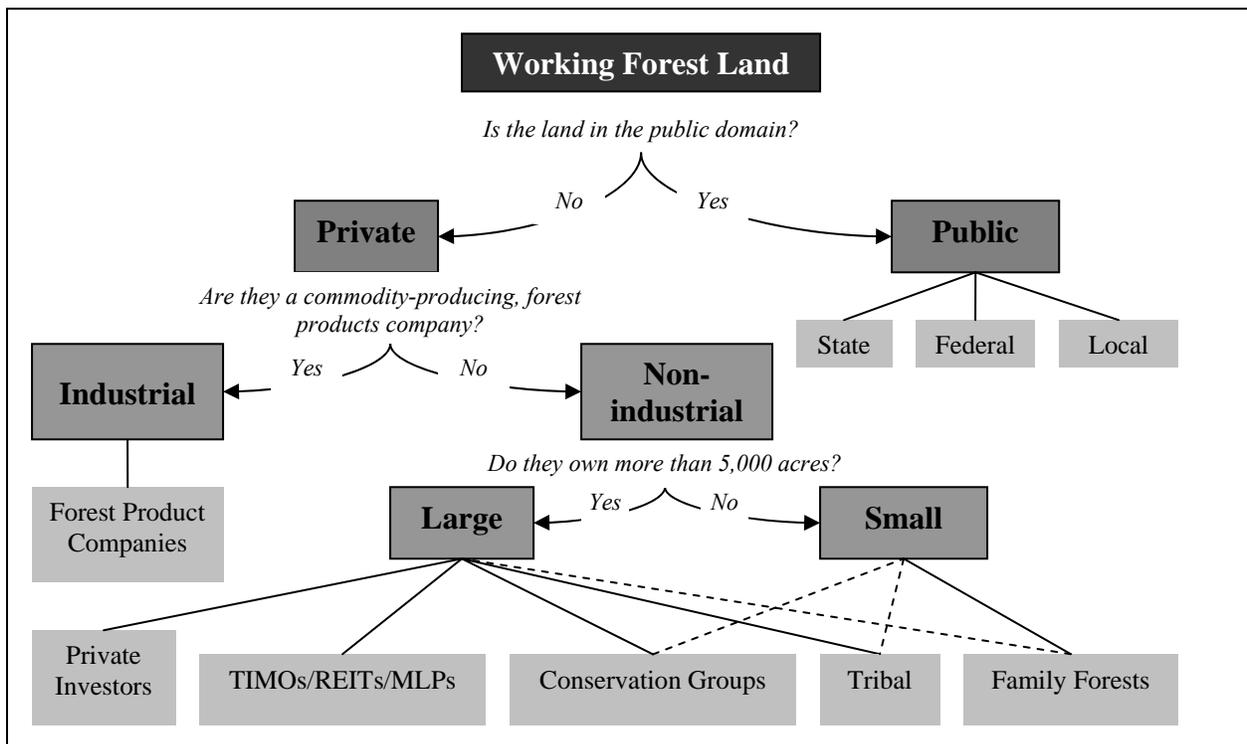


Figure 2. A Proposed Method for Distinguishing Among Forest Landowners

Distinguishing between public and private lands could be based on the requirement of public land being in the public domain, meaning the general public has common ownership of it. Private land would be any land not in the public domain; this includes tribal land since tribal lands are neither owned as “commons” nor are they bound by public land laws and regulations.

A simple distinction between industrial and non-industrial owners is needed: industrial lands are owned by commodity-producing forest products companies, while non-industrial lands are owned by everyone else. This is different than the now outmoded “NIPF” distinction that has been used to describe small forest owners; rather, non-industrial owners would include large corporations, private investors, TIMOs, REITs, MLPs, family forests, conservation groups, and other forest landowners.

After distinguishing between industrial and non-industrial forest landowners, there are two categories: large and small. Rather than basing our distinctions on names and titles, the differentiation between industrial and non-industrial would be based on a measurable distinction, allowing for more appropriately directed and easily implemented programs and policies. Albeit somewhat arbitrary, 5,000 acres could be the distinguishing size. The Small Forest Landowner Office, Washington Department of Natural Resources, directs its programs to landowners with less than 5,000 acres; thus, most of the family forests would fall in the “small” category. Conservation groups, TIMOs, REITs, MLPs, tribes, and large private investors (see Part 2) would most likely fall into the “large” category based on an assumption that it makes little financial sense for most of these groups to own less than 5,000 acres. There is some chance, however, that conservation groups and tribal land would amount to less than 5,000 acres, and that family forest owners could own more than 5,000 acres; therefore, these final owner categories are not necessarily directly tied to the “large” and “small” categories at all times.

Table 3 shows estimated acres of forest land in the above-discussed ownership categories, based on a combination of the 2004 FIA data, 2001 Small Forest Landowner Database, and assumptions of actual numbers of small forest landowners and acreages owned.

Table 3. Forest Land (Acres) by Ownership in Washington State: A Current Estimate

Forest land: 22,000,000			
Public: 12,600,000	Private: 9,400,000		
	Industrial: 2,900,000	Non-industrial: 6,500,000	
		Large: 3,300,000	Small: 3,200,000

These numbers are similar to patterns across the United States, as demonstrated in Table 4. Note that while the orders of magnitude of national and Washington ownerships are similar as a percent of total, Washington is more heavily weighted to public ownership due to its large holdings of state forests, national forests and parks.

Table 4. U.S. and Washington Public and Private Forest Ownership

Ownership	Acres	US %	WA%
National Forest	147,000,000	19.6%	-
Other Public	170,000,000	22.7%	-
Total Public	317,000,000	42.3%	57%
Forest Industry	68,000,000	9.1%	13%
Other Private	363,000,000	48.5%	30%
Total Private	431,000,000	57.6%	43%
All Owners	748,000,000	100.0%	100%

II. WHICH FOREST LANDS ARE EXPERIENCING THE GREATEST RATES OF CONVERSION?

Recent findings show that from 1982 to 1997, 10.3 million acres of non-federal forest land converted to non-forest uses, approximately 680,000 acres per year (Alig et al. 2003). It is estimated that close to 44.2 million acres of private forest land in the United States could experience large increases in development pressures between now and 2030 (Stein et al. 2005). Based on the National Woodland Owner Survey, there are an estimated 10.3 million family forest owners (not including corporations, partnerships, tribes, and other non-family organizations) in the United States, owning 262 million acres; 1.8 million acres of this forest land are expected to convert to development in the near future, with close to half of the loss to development taking place in the West (Butler et al. 2004).

Forests come under greatest threat when ownerships change. Table 5 divides U.S. private forest landownerships into two classes, “large” and “small”. At 5,000 acres or less, the important ownership change is intergenerational transfer. In this category, ownerships are entering the 4th or 5th generation; inheritors are many, are subject to divisiveness, and are driven primarily by financial motives.

Table 5. U.S. Forest Ownership Distribution by Size

	Size Class	Acres	Percent	Owners	Percent
LARGE	100,000+	65,000,000	17.62%	60	0.00%
	5,000 - 100,000	59,370,000	16.09%	2,350	0.02%
SMALL	1,000 - 5,000	14,843,000	4.02%	21,135	0.22%
	<1,000	229,753,000	62.27%	9,580,400	99.75%
	TOTAL	368,966,000	100.00%	9,603,945	100.00%

At 5,000 acres and up, the most important change is from a shift from strategic owners – the forest products industry – to financial investors. These owners, by nature and definition, are also driven largely by financial motives.

Note that the “large” category represents less than 1/4 of total owners, but 1/3 of private forest land, and nearly all the landscape level private forest land. This applies for the most part across the country, including Washington, presenting the most efficient policy and conservation target.

With regard to changes in ownership and impacts on commercial markets for timber and timberland, most recent activity has been in the private sector. Within this sector, increased competition from developed use can lead to loss of both commercial and public use forest. Western states, Washington included, are somewhat buffered against this by the high public forest component. Still, with approximately 40% of forest cover in private ownership, Washington is susceptible to forest loss through fragmentation, and development as a competitive investment environment seeks return wherever it can be found.

There are anecdotal assumptions surrounding forest land use conversion, proximity to town centers and major transportation corridors being the most commonly-cited, but so far there are few sources of actual data available for Washington. A project for western Washington, under contract by the FIA program, is analyzing the change of forest land use to other uses; these data are expected to be available by mid-November, 2005. By identifying areas of forest land use over a 20-year period, we will be able to identify areas of Washington that have changed from forest land use to low-density residential and/or urban land uses from 1988 to the present. However, since the data are based on remotely sensed land cover information, applying it to a statewide parcel level detail will not be possible. It will, however, provide an excellent view of forest land use change on a large scale. Fortunately, the Washington State Legislature recently approved a study to investigate this topic at a more detailed level; in select locations, parcel-level information will be used to identify change of ownership, parcelization/subdivision, and other patterns associated with the loss of overall forest land use characteristics.

III. HOW CAN TIMBERLAND AS A FINANCIAL INVESTMENT HELP REDUCE CONVERSION RATES?

This section focuses on the large owners, examining their behavior over the last 20 years. It is important to note that each shift in ownership within this class results in increasingly lower focus on long-term forest values.

Large private owners are defined as follows:

- **Forest Products Industry:** The traditional large landowners – vertically integrated to accommodate a high degree of raw material self-sufficiency for their lumber or paper mills. (*Examples: Weyerhaeuser Company, International Paper.*)
- **TIMOs (Timberland Investment Management Organizations):** Private companies acting as investment managers for institutional clients, primarily pension funds, endowments, and wealthy individuals. Timberlands are owned as illiquid direct investments or partnership shares, generally in separate accounts but frequently in pooled funds. (*Examples: The Campbell Group, Hancock Timber Resource Group, Forest Capital Partners.*)
- **REITs and MLPs (Real Estate Investment Trusts or Master Limited Partnerships):** Companies focusing mostly or exclusively on timber landownership with a high degree of liquidity through the public trading of shares on a stock exchange. (*Examples: Rayonier, Plum Creek Timber Company.*)
- **Private Investors.** Privately held companies or individuals, frequently family ownerships, generally focusing exclusively on timber-ship and the sale of logs. Can be oriented to long-term ownership (*Port Blakely Tree Farms, Murray Pacific*), or short-term ownership generally resulting in fragmentation and development (*Barrs & Glawson, Georgia*).
- **Arbitrage Investors.** Large-scale highly sophisticated “Wall Street” style investors operating hedge funds and partnerships with very large pools of capital, often multiple billions of dollars. Short-term in nature, with a view to acquiring entire companies and selling off assets. (*Examples: Madison Dearborn Partners recently acquired Boise Cascade; Cerberus Capital recently purchased the paper division of Mead-Westvaco.*)

- **Transaction Conservation.** Transaction-oriented non-profit conservation organizations that have traditionally acquired small parcels for preservation but are now turning to larger acquisitions of working forests or of working forest easements. Conservation has the potential to resolve or attenuate forest loss through the large-scale acquisition of working forest easements in partnership with financial investors. (*Examples: Cascade Land Conservancy, Pacific Forest Trust, Trust for Public Land, The Nature Conservancy, Ecotrust, The Conservation Fund.*)

1. The Evolution of Timberland as a Financial Investment

Large scale change generally takes place gradually, building speed and momentum as the conditions underlying it develop. This is true of the shift in ownership of industrial timberlands. It has taken two decades for financial investors to dominate timberland ownership, with most of that change occurring since 1996. The remainder of this paper will describe the three phases that characterize the shifting ownership resulting in the current structure.

Phase 1: 1983 to 1995 – Life Was Easy!

Plenty of land ▪ Low competition ▪ Expected returns of 8.0% on average ▪ Counter-cyclical to the stock market

The switch from strategic to financial investors started somewhat inadvertently in the early 1980's, when agricultural lenders, including John Hancock Mutual Life Insurance Company and Traveler's Life Insurance Company of Boston, 1st Atlanta Bank of Atlanta, and their institutional investment clients, found themselves with a growing portfolio of timberland and other agricultural assets through a series of loan foreclosures. These "investments" did well enough that these institutions began to promote timberland investment as a new financial asset class.

Applying portfolio theory to their new funds, they were able to demonstrate that not only did timberland yield attractive risk adjusted returns, but that historical timber returns were counter-cyclical to the stock market, making timberland investing a perfect diversification strategy.

With the usual splitting and shifting of organizations, the Hancock and 1st Atlanta timber groups gave rise to the Hancock Timber Resource Group, PruTimber, Wachovia Timberlands, Forest Investment Associates and several others. Timberland Investment Management Organizations, TIMOs for short, were off and running. Today, Boston and Atlanta remain the primary geographic centers of the investment timberland industry.

TIMOs were not the only financial timberland investors at that time. Sir James Goldsmith bought Crown Zellerbach and several other large timber-owning forest products companies in 1985, spinning off processing and marketing businesses and retaining timberland for arbitrage. This type of investor vigorously returned to the scene 20 years later.

At the time, markets were imperfect and economic conditions were favorable. Demand was high, Japan was rapidly expanding its economy, there was a perception of supply shortfall, and stumpage prices were increasing in real terms at the rate of 1.5% per year compounded. Most important, there was very little competition and investors were able to acquire timberland and associated assets for timber value alone. Other values, even development potential, came along without cost. Projected returns were about 8.0% on average, net of inflation, very attractive for what appeared to be a low risk investment.

In June of 1990, the spotted owl was listed as an endangered species and investment performance rose even higher. Western supply dropped by 50%, mills began to panic, and prices shot up,

making fortunes for private landowners and heroes of TIMOs. Some early investors saw returns of 25% or higher.

There was, however, a downside. As more investors were attracted to the market, they began to expect higher than “expected” returns, something the asset could not support for long. The success and maturation of the asset class began to create its own difficulties.

At the outset certain industry professionals with an eye to conservation promoted TIMOs as precisely what western states needed – a long-term, patient owner on a renewable asset that performed very well if managed with wisdom and patience, but that was subject to degradation if managed solely for short-term gain. Pension funds were debt-averse and had no need for near-term income, content to see their investment capital appreciate. That view was correct at the time, until the market began to tighten.

By the end of 1995, we had a new eco-friendly asset class with a \$5 billion portfolio poised for disappointment.

Phase II: 1996 to 2000 – Not So Easy After All!

Demand ↓ + supply ↑ ▪ Competition from REITs, MLPs, and Private Investors ▪ “Unlock Timberland Value”

The industry story was now one of supply. Mills closed in the West and capacity moved to the South, taking demand with it; the Japanese economy failed and western timber prices plummeted. Plantation technology advanced and a “Wall of Wood” was coming from every direction – the South, the Northwest, Canada, Australia, New Zealand, and South America.

At the same time, more investors were buying timberland, forcing timberland prices higher in the face of declining income. This was a classic disconnect between value and revenue.

Pressure was mounting on the forest products industry to increase current return on equity. Timberland, with much of its value in the form of capital appreciation, was not performing in the short term for public companies. This resulted in marching orders from Wall Street to “unlock timberland value,” i.e., sell it. Forest products companies found they could deliver greater value to their shareholders by selling their timberland to an investor with a lower cost of capital from whom they could, in turn, buy back raw material. The traditional need for raw material self-sufficiency was replaced by the realization that one needn’t own the forest in order to have it.

The separation of timber ownership from processing was in full swing and the forest products industry became net sellers. Figure 3 illustrates this point. Note that what the forest products industry lost, TIMOs gained. Note also that Arbitrage investors were net sellers as well. Sir James Goldsmith, who acquired his portfolio in 1985, sold it all in 1996; the “Arbs” will surface again.

Now a new class of investor entered the scene. In addition to TIMOs, the asset class began to attract so-called “pure-play” publicly traded corporate-style investors – Master Limited Partnerships (MLPs) and Real Estate Investment Trusts (REITs). The problem with TIMOs is a lack of liquidity – once an investor buys in, it is difficult to exit. REITs and MLPs, with shares publicly traded in the stock market, resolve that issue. The problem they face, however, is similar to that faced by publicly traded forest products companies – pressure to always generate high and steady current income in order to maintain share value.

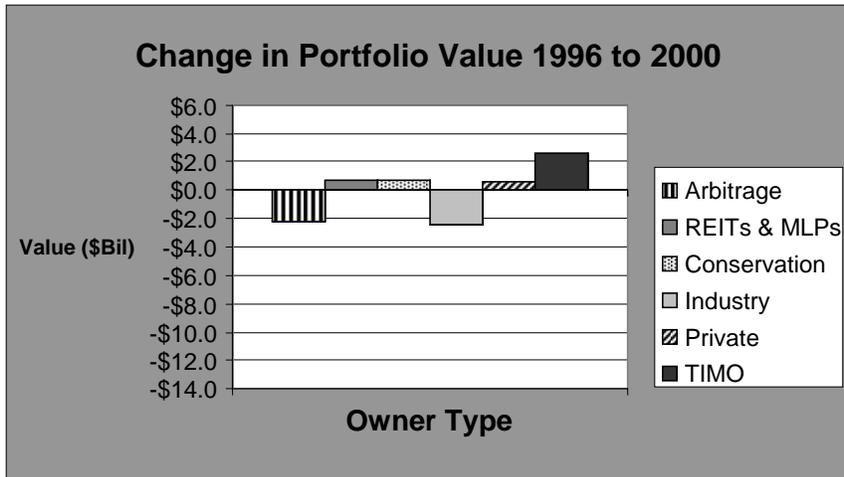


Figure 3. Change in Timberland Portfolio Value 1996 to 2000

Crown Pacific is a classic example, a company that built a portfolio of approximately one million acres over a 10-year period and went bankrupt last December. During much of its tenure, as debt mounted and markets fell, it developed a reputation for over-harvesting in order to meet debt service and earnings goals. There have been other notable failures that have touched the West; Strategic Timber Trust and U.S. Timberlands are two more would-be big successes that have cost investors a lot of money and the landscape a lot of trees.

Most REITs and MLPs have failed, but not all. Plum Creek Timber Company is the largest timber landowner in the U.S., with roughly 8 million acres of land, and Rayonier, another big player with a substantial presence in Washington, are both REITs. Potlatch is in the process of converting to a REIT. Thus far, these companies have been successful, but, in the eyes of some professionals, their future is dubious; they are subject to current earnings pressures and both companies have recently created real estate divisions to enable them to find full value for their investors.

Another substantial buyer in the market is the so-called “private investor.” These are not to be confused with the typical small landowner; they consist of ten or fewer wealthy investors and their co-investors with a penchant for quick action and high risk. In the South they are known as “pin-hookers” for their strategy of buying and quickly reselling, generally fragmenting larger ownerships in the process. There are some excellent managers in the industry as well. On the private side, Port Blakely Tree Farms and Merrill & Ring have always been known for careful stewardship. Conservation organizations, such as Cascade Land Conservancy, The Trust for Public Land, The Conservation Fund, and The Nature Conservancy have become increasingly active on a landscape level.

Phase II ends with the forest products industry downsizing their portfolio by \$2.5 billion and TIMOs adding an equivalent amount to theirs. TIMOs have been as aggressive as other buyers in their effort to compete, but they have three positive traits that have implications for their ability to manage sustainably in the future; they tend not to carry debt, they would rather focus on timber value, and their investors tend to be patient. These attributes make them likely future partners in landscape-level working forest conservation strategies.

Phase III: 2001 to Current – Here Come the Arbs!

The “tech” bust ■ Too much capital, too few acres to buy ■ Expected returns decline to 6% ■ Large-scale arbitrage

In 2002 and 2003, it looked like things might improve. Investors, impatient with poor returns, were beginning to put pressure on their managers to become more realistic in their assumptions and to pay less. A correction seemed imminent; however, the tech bubble burst, the stock market declined dramatically, and institutional capital began seeking a new home. Five to six percent returns from timber suddenly looked attractive as a safe place to park capital. So instead of demanding higher returns and lower prices, investors capitulated to low yield, with the caveat that managers must aggressively seek value wherever it could be found. Today, TIMOs and other investors are awash with cheap capital, and once again there is a sellers’ market and continuing pressure on parcelization and development.

Figure 4 illustrates the market profile by the end of 2004, and the likely condition for the foreseeable future.

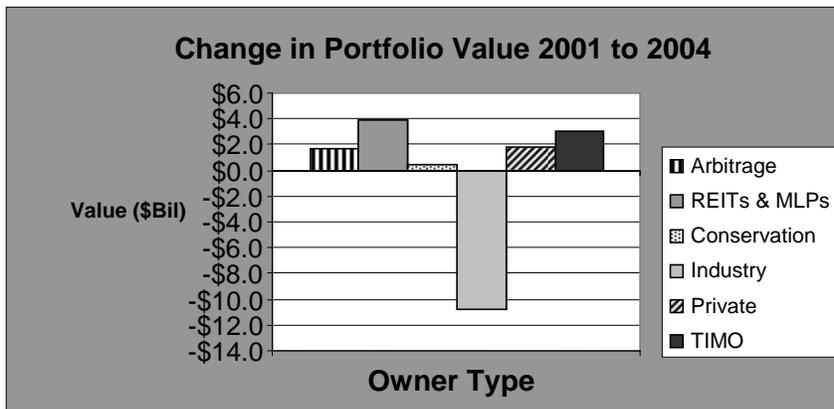


Figure 4. Change in Timberland Portfolio Value 2001 to 2004

Private investors have always been a factor, but never so much as now. The buyers referred to as “pin-hookers” in Phase II accounted for 27.9% of the \$5.0 billion that traded in 2004. And, again, a new investor has entered the scene or more precisely, an old investor has returned. Recall Sir James Goldsmith in the mid-80’s; Sir James died years ago, but his successors are back. These are very large arbitrage specialists who acquire companies whole, then actively spin off assets in transactions engineered to generate the highest possible return. They are highly leveraged, very sophisticated investors with little patience and little concern for sustainable forest management. Rapid turnover is their primary driver.

Just in the last year, there have been two such mega deals for Boise Cascade and Mead Westvaco, with a total of 3 million acres. Madison Dearborn Partners, the buyers of Boise Cascade, almost immediately sold all of the former Boise timberlands to Forest Capital Partners for \$1.65 billion. Cerberus Capital, the buyers of the Mead-Westvaco paper division recently sold 650,000 acres to Plum Creek for \$345 million.

Today, a buyer who bids only on timber cannot hope to compete, and “Higher and Better Use,” otherwise known as “HBU,” or real estate, has become a large component of return.

Conservation in the Future: It's the HBU!

Direct partnerships with financial investors ■ More conservation capital ■ Faster capital deployment ■ Focus on conservation ■ Seek low-cost partners

The increasing competition among institutional and private investors over the last few years has taken the focus from forest management and placed it squarely on fragmentation and development, and keeping forests intact as working forests. In order to do this, however, conservation organizations are required to behave more efficiently than they have in the past; they must think more like financial investors, and, in fact, partner with them through efficient use of landscape-level working forest easements. In this way conservation groups can invest with the financial buyer at the wholesale level, rather than employ its traditional retail strategy of acquiring small conservation components after the larger transaction is accomplished. Conservation investment has a relatively lower cost of capital than do financial investors. Properly applied, this can result in a competitive advantage that will attract TIMOs to partnerships with them and allow scarce conservation capital to go much further.

The following suggests ways in which policy makers and the conservation community might increase their effectiveness in the future:

- Relationships between conservation groups and TIMOs, which focus on managing working forests, should be developed. Other investment vehicles and fragmentation specialists are less attractive.
- More rapidly deployable funding must be made available to conservation groups; if conservation groups are to partner with financial investors, their capital must be deployed alongside that of their partners in order to achieve parity of risk and to align interests.
- Conservation groups should focus on the conservation components of transactions rather than on the acquisition of the commercial component. The commercial component is better left to financial partners; they are better able to manage for financial return, particularly when the conservation component determines the course of management events.
- Conservation groups must find those partners with the lowest cost of capital. With a surfeit of 6% capital available, it makes no sense to partner with someone who needs 12%.

IV. Summary

Washington's private working forests are owned by industrial forest product companies, large publicly-traded and other investment-type companies, families, conservation groups, tribes, and various other individuals and groups. The pressures of forest land conversion differ among the ownership groups, and appropriate actions and programs must be directed toward the specific groups. Finding appropriate solutions for timberland investors is key in order to slow the rate of conversion on large owners' lands. The same strategy would apply to small forest land owned lands, but not as focused on the investment side; rather, targeting conservation easements, family inheritance/legacy issues, property taxes, aesthetics, and other values of other services for landowners who are not as driven by finances would be more appropriate. Actions and recommendations produced by the Northwest Environmental Forum need to address the different ownership groups, commonly-defined by all participants. On-going and future studies on ownership and land conversion, such as the Future of Washington's Forests studies mandated by the Legislature and the implementation of a new statewide small forest landowner database should incorporate the recommendations of this paper into the project designs.

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