Forest Research Group

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Lions and TIMOs and Bears, Oh My!

I Sense a Disturbance in the Forest

Since January, I have attended three meetings and been interviewed by two reporters where the topic has been (or included) the impact of the transfer of the nation's industrial timberlands to private investors and TIMOs and REITs. The concern is literally being expressed from coast to coast (Orono, Maine to Seattle, Washington). This issue of Forest Research Notes contains some thoughts on this issue.

The topic was the subject of presentations at the Annual Meeting of the Southern Forest Economics Workers (SOFEW) in Knoxville, TN, in March; at the New England Society of American Foresters Winter Meeting in Nashua, NH in April; and at a seminar at the University of Maine at Orono in May. I talked with a reporter for the Arkansas Democrat-Gazette shortly after it was announced that International Paper had sold all its Arkansas timberland to two investor groups. Very recently I talked about the issue with the Seattle correspondent for The Economist.

The question is usually framed as: "What will happen to our forests and our forest products industry (jobs) when the forests are owned by investors with short time horizons?"

The concern is that the short-term outlook of the investors will cause a disturbance in the forest. The issues usually include:

- Short-Term Ownership
- Fragmentation/HBU
- Impact on Industry
- Forest Research

How Long is Long-Term?

When has American industry ever been praised for its long-term outlook? And just how long has the forest products industry owned the forest that it was expected to keep forever?

It was only 100 years ago that a crazy man named Frederick Weyerhaeuser was running around the Pacific Northwest buying and ***keeping*** timberland. He started in 1900 with 900,000 acres of timberland he bought from the Northern Pacific Railway (www.weyerhaueser.com). (If we allow 60 years for a rotation of Douglas-fir sawtimber, Weyerhaeuser Company has held those lands for *almost* two rotations.)

How long did the Northern Pacific own the lands it sold to Frederick Weyerhaeuser? About 40 years. The western railroads began receiving land grants from the federal government in the 1860s. The plan was that that they would sell the land to raise revenues and generate traffic (from farms, mines and forests). The Burlington Northern (formed by a merger that included the Northern Pacific) held some of its timberlands until it spun off Plum Creek in the late 1900s—about 120 years.

Prior to 1900, industry would buy land, cut it, sell the carcass and move on. This practice is responsible in part for the creation of National Forests and National Parks in the eastern United States. For example, the State of New Hampshire spent the last half of the 19th Century selling off a million acres of state-owned public lands in the White Mountains to the forest products industry. By the beginning of the 20th Century, most of the timber had been removed from the mountains. Bruns (1969) estimated that only about 5,000 acres in the region were *not* cut.

The Weeks Act in 1911 authorized the federal government to buy lands in the East. A tremendous effort by the Society for the Protection of New Hampshire Forests, the State of New Hampshire and the US Forest Service resulted in the creation of what is now the White Mountain National Forest. (If we allow a minimum of 100 years to grow a nice hardwood sawlog, the federal government has held those lands for about one rotation.)

In the South, there were family-owned sawmills which often held a few thousand acres of timberland to support those mills and the naval stores industry. Some of these families may have held those lands for 200 years or more. But the pulp and paper industry did not exist to any great extent in the South until the middle of the 20th Century. Josephson (1989) notes that pulping capacity rose from about 3,000 tons per day in 1930 (about as much as two modern mills produce in 24 hours today) to about 12,000 tons per day in 1940 and 130,000 tons per day in 2000 (Smith et al, 2003). Most of the large industrial holdings in the South existed only for 50-60 years, and most of them were assembled from scattered tracts of former farm lands and family timberland holdings. (If we allow 25 years for a rotation of southern pine, industry held those lands for just over two rotations.)

Long-term land holders? Champion International was still assembling a timberland base in Northeast Georgia in the 1960s and 1970s (sold to a TIMO in the mid-1990s) and Container Corporation of America was still adding to its land base in southern Georgia and Alabama in the 1980s (sold to a REIT in 1999).

Are investors really focused on the short-term? Some TIMO clients are. For example, commingled funds usually run 10-20 years, so yes, they are short-term. But separate accounts can hold the land for as long—or as short—a time as industry has. Timberland REITs should have the same long-term outlook for its timberland as people used to think industry had. In fact, the three publicly-traded REITs (Plum Creek, Rayonier and Potlatch) all used to be forest industry corporations.

A related concern is that frequent turnover of ownership may be a problem. If one TIMO sells to another, is that a problem? Is it any different than a change in corporate ownership? Between 1990 and 1999, the 2 million-acre Great Northern Paper timberlands in Maine were owned by Great Northern Nekoosa, Georgia-Pacific and Bowater. After that, great chunks of land were sold to TIMOs, industry and NGOs. International Paper's remaining million acres in Maine, which it sold to GMO, were Champion lands before 1999 and St Regis lands 15 years before that.

A change in corporate or investor ownership may lead to changes in forest management strategies, but it could be argued that strategies among investors are likely to be more similar (maximize returns) than they are among corporate owners (maximize returns or minimize wood costs to the mill or insure a wood supply or maximize cash flows to improve earnings or etc.)

Changing strategies? In the early 1980s, Wall Street ***knew*** that the only way forest products companies could earn an adequate return for their investors was to be self-sufficient (or nearly self-sufficient) in wood supply. By the mid-1990s, Wall Street ***knew*** that forest products companies should not own timberland at all.

Local people often wonder what will happen to the forest when a new owner takes over. The difference in strategies between industrial ownership and investment ownership can be substantial, but frequently the people on the ground remain the same. Often when tens or hundreds of thousands of acres change hands, the field foresters change hands, too. There are timberland parcels across the country that have changed hands 3 or 4 times over the past 15 years that have always had the same foresters managing them in the field. Those foresters have started the day sitting at the same desk, in the same building—they just hang a new sign out front, change the decal on their hard hats, (sometimes) paint their truck a different color, and go out and harass the same loggers as the day before.

There are interesting questions that foresters face when managing timberland for a fund with a certain termination date. Growing trees is a long-term effort that rarely fits within a 10-year investment. When a bridge needs to be replaced, how good a bridge should you put in? If you think you are going to own the land forever, you put in a bridge that will last a long time. If you have three years left in a 10-year investment, do you put in a bridge designed to last for 30 years? Or a cheaper one that will last for 10? (If you build too cheap a road system, it may affect the price you get for the property in three years.)

Fragmentation

There is concern that investor ownership will result in fragmented forest ownerships. The concern is that the TIMOs and REITs will buy huge timberland tracts and break them up. But it has only been in the last five years that investors have been buying entire timberland estates. Before that time, they were buying outlying properties that were often described as outside the core holdings of a company—those furthest from the mills. They were buying cast-off fragments from the forest products industry.

International Paper's timberlands in the New York Adirondacks were spread across the region interspersed with state-owned Forever Wild lands. Not all these lands have been sold directly to investors. NGOs have bought some of these tracts over the last decade or two and split them up, with some parts being sold or donated to the state and other easement-encumbered parts sold to investors. The TIMOs are buying up the fragments and assembling them into larger holdings.

Since 1994, International Paper has sold just over 3,000,000 acres of Northeast timberland in transactions of 5,000 acres or more in about 30 transactions from Maine to Pennsylvania. The industry giant never owned 3 million acres at once in the Northeast, but kept buying and selling—much like people worry TIMOs will do. These parcels have gone to states, industry, NGOs, TIMOs, loggers and private investors.

Investors do not always fragment their timberland. For example, Plum Creek (REIT) has assembled a land base of over 1 million acres in Maine since 1997 and Wagner Forest Management (TIMO) has assembled over 1.5 million acres in northern New England since 1994. On the other hand, Hancock Timber (TIMO) began assembling its Northeast holdings in 1993 and held over 500,000 acres at its peak. But it was gone from the region by 2004—only to return in 2005 with the purchase of a large tract in Pennsylvania that International Paper had sold to a different TIMO in 1997.

Related to fragmentation is the issue of development. There is a concern that the TIMOs and REITs will sell off the land with a higher and better use (HBU). This is a valid concern. The TIMOs and REITs are in timberland for the money. If they can't make money growing trees, they will sell the timberland as house lots or kingdom lots. Most recent large transactions have included a careful analysis of the HBU potential of the target property as part of their acquisition analysis. But the ability to sell of hundreds of small parcels is often restricted by wood supply agreements. The acres of HBU land have been limited to 20% or less of the total acres on several recent large transactions.

But large portions of the Northeast's lake frontage had already been developed before the lands were sold to investors—they had just not been *sold*. It was common practice for the paper companies to lease lakefront lots to people who wanted to build a camp on the lake. TIMOs and REITs have frequently sold these lots to the lease holder. So the investors are selling off the lakefronts, but often to people who already have a camp on the land.

Impact on Industry

What happens to industry when TIMOs and REITs own all the timberland? As noted above, the investors are buying timberland to make money growing trees. They must have wood-using mills near their timberland in order to do this. The more mills, the better.

So the health of the forest products industry is vital to the investors' ability to make money from trees. If the mills close, the TIMOs and REITs lose. Sometimes when pulp mills close, the adjacent paper mills and converting plants keep operating. This may be good for the local community because some jobs are saved, but it does nothing for timberland owners.

Biomass energy and bio-refineries are currently a hot topic in areas where pulp mills are struggling to survive. They use low-quality wood, which provides an outlet for such material from timberlands, but there are even cheaper sources of fiber that may be used. Maine has found it is cheaper to burn construction and demolition debris imported from Massachusetts than to burn chips produced in the Maine forests.[1] This may provide some benefit to the state economy, but it does not help timberland owners.

If states are concerned about what the TIMOs and REITs will do with their timberland, they need to make sure there are places for those investors to sell their wood.

Research

Another common concern is what will happen to forest research. Many forest products companies had significant forest research laboratories (e.g., IP at Georgetown, SC and G-P at Crossett, AR). Others provided land and forest stands on which government, universities or research cooperatives could conduct long-range growth and yield experiments.

There is no fundamental reason why research funding could not continue at previous levels. Both the forest products industry and the investor-owners will benefit from continued research. Some of the TIMOs and REITs already belong to the research cooperatives based at southern universities. The possibility of growing wood faster should lower costs for industry, so they should be willing to contribute as well.

The main risk is that experimental plots may disappear. When industry owned the land, they would set aside stands for experiments. They also set up continuous forest inventories, where individual trees were marked and periodically measured. If the land turns over every ten years, it is more likely that such plots will disappear. And what happens to the research records?

On the Other Hand

On the other hand, the world ***is*** changing. Many timberland investors ***do*** have a short-term focus. Large tracts ***do*** get parceled among individual investor and funds. The focus on maximizing total returns ***can*** result in different forests than if other strategies were used. The need to maximize returns ***can*** result in more HBU lands being sold by investors. But are the TIMOs and REITs behaving differently than the forest product industry?

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[1] The Bangor Daily News reported that biomass chips cost \$9/ton to the Old Town mill's biomass boiler, while construction and demolition debris chips cost \$4/ton. (Bangor Daily News, *Old Town Mill Closes*, March 17, 2006. The Old Town mill is over 200 miles from the closest MA point on the MA border.