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History and Outlook for US Timberland Investment

BY BROOKS MENDELL

Over the past 50 years, US industrial timberland ownership shifted from vertically integrated firms that owned sawmills and paper plants to forest management specialists. The financing and history of timberland investments continues to teach us how different timber-related investments—though anchored to a common asset—provide distinct investment opportunities



while creating new markets and services for traditional forest managers.

Cigars and timberland investing

The glamorous world of large-scale timberland investing in the United States evolved from mundane yet structurally powerful legislative changes. In 1960, President Dwight D. Eisenhower signed a collection of unrelated tax laws known as the Cigar Excise Tax Extension of 1960. The second half of this 13-page bill comprised the Real Estate Investment Trust Act of 1960. Real estate investment trusts, or REITs (pronounced “reets”), are companies that own and manage income-

producing real estate of various types, such as office buildings, warehouses, and timberlands.

REITs address “double taxation,” whereby a firm pays corporate income taxes and shareholders also pay taxes on the after-tax income distributed as dividends. With REITs, shareholders pay taxes on dividends received, but firms do not pay taxes on the rental income generated from their real estate holdings. Though intended for traditional commercial real estate like office and apartment buildings, after additional changes years later, it transformed timberland-owning companies in the United States.

Meanwhile, the forest industry began changing on its own.

The forest industry restructures

In 1969, 14 of the 15 largest US timberland owners were vertically integrated, mill-owning forest industry firms; as of 2017, only two of the top timberland owners from 1969 still hold places on the list (Table 1). Years ago, integrated forest industry firms dominated the industry; today, timberland specialists (in the form of real estate investment trusts) and asset managers control the largest investment-grade forests.

Part of this shift resulted from a fundamental economic disconnect. In 1978, analyst Thomas Clephane issued a report from investment bank Goldman Sachs dissecting the timberland ownerships and values in the forest products industry. His analysis indicated that the stock prices of most of the largest public forest products and paper companies were trading below the value of their timberlands. Clephane estimated that firms such as Crown Zellerbach, Weyerhaeuser,



PHOTO COURTESY OF OLYMPIC RESOURCE MANAGEMENT

Investing in good site preparation can add to timberland value.

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International Paper, and Potlatch owned timberlands valued at two to three times the value of their stock prices.

This difference in value between the timberlands and the shares of certain firms provided investment opportunities for shareholders and the firms themselves. The forest industry began selling timberlands prior to the recession of 1981 and 1982, and the opportunity to generate cash from these assets balanced broader forest industry struggles. Firms were closing mills,

Table 1. Top 15 Industrial Timberland Owners & Managers, 1969 versus 2017

1969			2017	
Rank	Firm	Type	Firm	Type
1	International Paper	Forest Industry	Weyerhaeuser	Public REIT
2	Weyerhaeuser	Forest Industry	Hancock Timber Resource Group	TIMO
3	Georgia-Pacific	Forest Industry	The Forestland Group	TIMO
4	Great Northern Nekoosa	Forest Industry	The Nature Conservancy	Conservation
5	St. Regis Paper	Forest Industry	Forest Investment Associates	TIMO
6	Boise Cascade	Forest Industry	Resource Management Service	TIMO
7	Scott Paper	Forest Industry	Rayonier	Public REIT
8	Champion International	Forest Industry	Campbell Global	TIMO
9	Kimberly-Clark	Forest Industry	Molpus Woodlands Group	TIMO
10	Burlington Northern	Railroad	Sierra Pacific	Forest Industry
11	Union Camp	Forest Industry	Potlatch	Public REIT
12	Continental Group	Forest Industry	Green Diamond Resource Co	Forest Industry
13	Crown Zellerbach	Forest Industry	J.D. Irving	Forest Industry
14	Potlatch	Forest Industry	Wagner Forest Management	TIMO
15	Diamond International	Forest Industry	The Conservation Fund	Conservation

Note: Does not include large 2017 transactions announced by Potlatch and Green Diamond.

SOURCES: Forisk Consulting, "North American Timberland Owner & Manager List, 2016," available at <http://forisk.com/product/forisk-timberland-owner-list>; and Gordon A. Enk, "A Description and Analysis of Strategic and Land-Use Decision Making by Large Corporations in the Forest products Industry," PhD dissertation, Yale University, 1975.

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Ron Boldenow, Ph.D., C.F., Forestry
Rebecca Franklin, Ph.D., Dendrochronology
Bret Michalski, M.S., Wildlife Science

<http://cocc.edu/forestry> E-mail: bmichalski@cocc.edu (541) 383-7756

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laying off workers, and writing off hundreds of millions of dollars. The sale of timberlands accelerated.

Timberland investments go institutional

Timberland sellers found interest from institutions looking to diversify their pension plans. The Employee Retirement Income Security Act of 1974 (ERISA) triggered a change in how pension funds invested. Congress designed ERISA to regulate private pension plans, requiring them to diversify beyond bonds and stocks. Timberlands, with their regular cash flows and inflation-hedging characteristics, became a viable alternative.

Timberland investment management organizations (TIMOs) stepped in to support institutions with these timberland transactions. TIMOs provide management services; they do not own timberland themselves. Institutions placed funds with the TIMOs as their intermediaries, and the TIMOs would acquire and manage timberland investments on their behalf.

Over the past 30 years, TIMOs have grown in number and size. As of February 2017, approximately 20 TIMOs managed nearly 25 million acres in the United States on behalf of institutional investors. Table 2 lists the top six that manage nearly 2 million acres or more each, for a total of 16.2 million acres.



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4033 S.W. Canyon Rd. • Portland, OR 97221 • 503-224-8046 • Fax 503-226-2515
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Editor: Lori Rasor, rasor@safnw.org

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State Society Chairs

Oregon: Werner Krueger, 777 NW Garden Valley Blvd., Roseburg, OR 97471; 541-464-3277; wkrueger@blm.gov

Washington State: Wendy Sammarco, 11707 346th Ave. NE, Carnation, WA, 98014; 206-233-1569; wpsam29@gmail.com

Inland Empire: Bill Love, CF, Inland Forest Management, 214 S. Center Valley Rd., Sandpoint, ID 83864-9542; 208-263-9420; inlandempiresaf@gmail.com

Alaska: Jeremy Douse CF, Tanana Chiefs Conference, 122 1st Avenue, Ste. 600, Fairbanks, AK 99701; 907-452-8251 x3374; jeremy.douse@tananachiefs.org

Northwest Board Members

District 1: Keith Blatner, Professor and Program Leader for Forestry, School of the Environment, Washington State University, Pullman, WA 99164-99164; 509-595-0399 (c); 509-335-4499 (o); blatner@wsu.edu

District 2: Mike Cloughesy, Oregon Forest Resources Institute, PO Box 463, Silverton, OR 97381; 503-329-1014; cloughesy@ofri.org

Please send change of address to:

Society of American Foresters
10100 Laureate Way
Bethesda, MD 20814
membership@safnet.org

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Next Issue: Reciprocal Rights-of-Way Issues

Timber REITs are born

While institutional timberland investing came of age in the 1980s, timber REITs arrived in 1999, beginning with the conversion of Plum Creek from a master limited partnership to a REIT. Between 1999 and 2006, four publicly traded forest products firms converted more than 12 million acres of industrial timberlands into these corporate structures. In addition to Plum Creek, the new REITs included Rayonier, Potlatch, and briefly, Longview Fibre.

In 2008, the *Journal of Forestry* published the first peer-reviewed research evaluating timber REIT performance (“Investor Responses to Timberlands Structured as Real Estate Investment Trusts [REITs]”). The study analyzed stock market responses to announcements by forest industry firms of their decisions to restructure from traditional corporations to more tax efficient REITs. The analysis concluded that investors prefer holding industrial timberlands in a REIT structure, reinforcing the importance of tax policy on investor preferences.

Weyerhaeuser made the REIT conversion in 2010, becoming the fifth firm to convert. Finally, in December 2013, CatchMark Timber Trust, formerly the private REIT known as Wells Timber, became the sixth timber REIT to trade publicly.

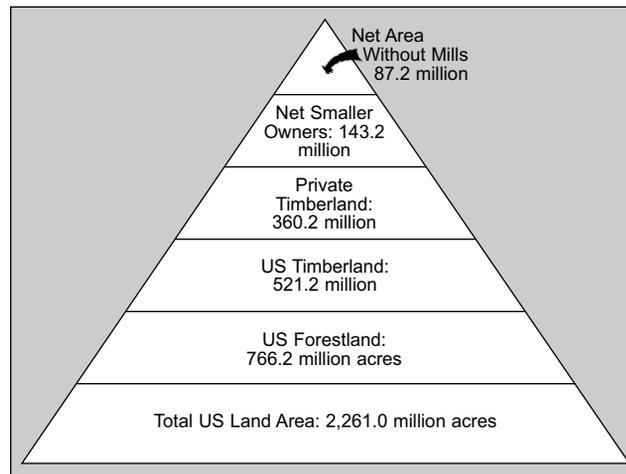
In February 2016, the completion of the merger of Plum Creek and Weyerhaeuser, the two largest timber REITs, reshaped the sector once more. The new firm held more than 13 million acres across 20 states (and Uruguay) and three dozen forest products manufacturing facilities. However, the merger requires historical and spatial context.

Table 2. Largest TIMOs by US Acres Under Management, 2017

Firm/Organization	Type	US Acres
Hancock Timber Resource Group	TIMO	3,637,492
The Forestland Group	TIMO	2,729,644
Forest Investment Associates (FIA)	TIMO	2,381,201
Resource Management Service (RMS)	TIMO	2,339,206
Campbell Global	TIMO	2,260,276
Molpus Woodlands Group	TIMO	2,110,964

SOURCE: FORISK 2017

Weyerhaeuser still accounts for a small portion of private US timberlands and only a fraction of the entire “investable universe” of industrial and institutional quality assets in the country (Figure 1). Clearly, 13 million acres represents a meaningful share of the industrial timberland universe. How-



DATA SOURCES: FORISK 2015 TIMBERLAND OWNER LIST; BUTLER 2008 (US FOREST SERVICE)

Figure 1. Investable Universe for US Timberlands.
Note: Forisk screened out 75% of the private timberlands in the Intermountain and Pacific Southwest Regions, and 50% in the North Central Region because of low mill densities.

ever, these acres are only part of a broader, actively managed space that includes millions of small- and mid-sized private landowners.

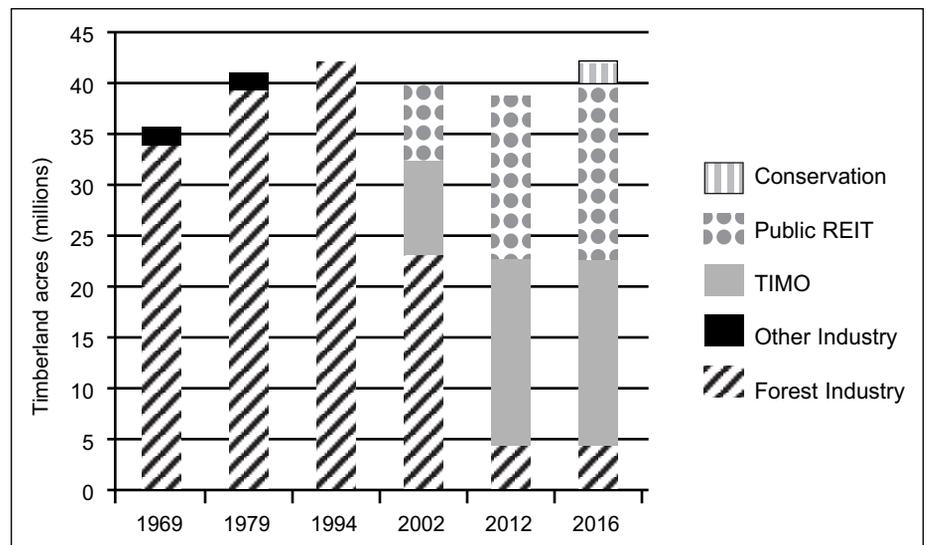
The merger reminds us of the limited growth options for REITs and TIMOs. Few opportunities remain to acquire timberlands from integrated forest industry firms. Increasingly, TIMOs and REITs are buying and selling timberlands from and to each other. Figure 2 summarizes the concentration and conversion among the 15 largest timberland owners and managers over the past five decades.

What does the future hold for timberland and forest management in the west?

The critical events driving change in industrial timberland ownership relate to new legislation, tax policy, and mergers. ERISA's passage in 1974 spurred demand for timberland by institutional investors. Plum Creek's reorganization from a master limited partnership to a REIT in 1999 demonstrated how other firms could become IRS-qualifying, timberland-owning REITs. And Weyerhaeuser's REIT-conversion provided the path for its merger with Plum Creek.

Fortunately, the presence of TIMOs and REITs has not diminished the demand for intensive and responsible forest management. In 2017, Forisk surveyed the silvicultural practices of 15 industrial and institutional timber-

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SOURCE: SOURCE: MENDELL, B.C. 2016. FROM CIGAR TAX TO TIMBERLAND TRUSTS: A SHORT HISTORY OF TIMBER REITS AND TIMOS, FOREST HISTORY TODAY, SPRING/FALL 2016: 32-36.

Figure 2. Top 15 US Industrial Timberland Owners by Type, 1969-2016.

land owners and managers for 4.3 million acres of privately owned forests in Idaho, Montana, Oregon, and Washington.

Firms actively employed silvicultural practices to improve growth and yields on lands, though activities varied between markets east and west of the Cascades. Chemical herbaceous weed control was most prevalent in western Oregon (75% of planted acres) while it was used on less than half of planted acres in the other regions. Only 40% of respondents applied fertilization. Pre-commercial thinning was reported by 93% of firms, while commercial thinning was less common. Average final harvest age was between 50 and 52 years west

of the Cascades and 72 years to the east.

What can investors expect from timberlands in the future? If US timberlands are historically expensive, it reminds us that investing relies on relative performance. US 30-year government bonds, a “riskless” alternative, yield 2.9%. Low interest rates, in part, reflect a low demand for money and higher demand for savings and investment. Timberland, like bonds, provides a way to preserve wealth and store value. As real, long-term assets, they continue to provide a safe-haven and portfolio diversifier for a range of investors. And these investors rely on experienced professionals—whether forestry consultants or TIMOs or

agencies—able to provide responsible forest management and attentive relationships with timber markets.

This interest in active forest management bodes well for the commitment from landowners, whether integrated firms or institutional investors or REITs, to forest productivity and sustainability. However, the world of institutional and corporate timberland investing referenced in newspaper headlines requires context; it accounts for a small portion of US forests. And while changing title to a forest is easy, changing the structure and landscape of a forest takes time. ♦

Brooks Mendell is president and CEO of Forisk Consulting (www.forisk.com). He is the author of “From Cigar Tax to Timberland Trusts: A Short History of Timber REITs and TIMOs” (Forest History Society, 2016), from which portions of this article are drawn. Brooks can be reached at bmendell@forisk.com.



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