



## Financing Sustainability - A Case in Point

**New Study Shows Long-Term Financial Advantages of Community Forestry: Despite up-front costs, ecologically-responsible management returns higher economic rewards than industrial forestry model over 60 year period.**

A new study released by the non-profit *Institute for Sustainable Forestry* (ISF) demonstrates the long-term financial advantages of an ecologically-responsible “Community Forest” management model. The study found that this balanced, environmentally-sensitive approach to forestry would generate \$1.1 billion more income than traditional industrial timber management over a 60-year period.

The study team used the forestlands of the troubled Scotia-Pacific Company (ScoPac) as a case study due to the copious amount of publicly-available data regarding the company’s finances and the condition of the company’s lands. The team also had input from other foresters, forest economists, investors, and environmentalists.

The ScoPac case study is stark, but is by no means unique. Throughout the North Coast forest fragmentation is a real and increasing concern driven by high debt loads, increasing operational costs, static prices for sawlogs, and high real estate values. Under these conditions timberland owners and managers have significant incentives to forfeit future harvests, keep inventories low and to subsidize current operational costs with land sales to private investors and speculators.

### ISF’s valuation makes three things clear:

- First, SCOPAC lands are currently saddled with debt payments approximately \$300 million in excess of what can be retrieved from sale of timber over the first 30 years of under current industrial (the “traditional timber model”) management.
- Second, *ecologically responsible management (the “community forest” model)* of the SCOPAC timber resource would produce \$1.46 billion more income than traditional industrial timber management over the second 30 years.
- Third, ecologically responsible management would produce \$365 million less revenue than traditional industrial management over the first 30 years.

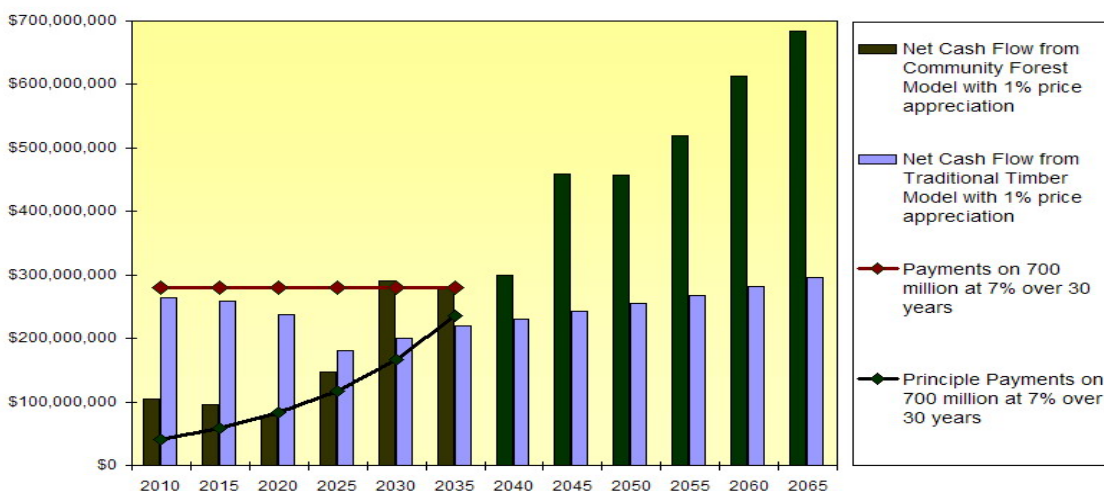


Figure 1: The difference in harvest revenues over time between traditional industrial forestry and the ecologically-responsible ‘community forestry’ model.

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ISF's Scopac valuation offers an example of the pressures facing timberland owners and managers throughout the north coast. Industrial and non-industrial owners alike are caught between increasing costs – both operational and regulatory – and log and lumber prices projected to remain relatively flat for the foreseeable future.

ScoPac's current debt structure presents a significant economic challenge for management and staff committed to sustaining ScoPac properties as a working industrial forest. In addition, real estate values that exceed values justified by timber and ranching income require many non-industrial landowners to face a difficult choice between maintaining rural ranches intact for the next generation and augmenting declining timber income through subdivision and sale of portions of their properties to real estate developers – particularly when ownerships change hands.

Forest fragmentation not only threatens environmental quality and the conservation potential of working forests it also threatens to curtail active management of local timberland and the future supply of sawlogs available to support local timber mills. In short fragmentation will change the character of Humboldt's rural economy, forested landscape and quality of life.

Significantly, the ISF valuation found that the current financial structure of ScoPac is unsustainable under *any* forest management plan without a significant infusion of capital to reduce outstanding debt. Publicly traded corporations require managers to maximize returns for shareholders. The disparity between short-term returns and discounted long-term investments indicate that long-term fiscal and ecological stability and sustainability may be best supported by alternative ownership models.

New signs of cooperation between conservation groups and practitioners of sustainable forestry indicate that "community forest" management scenarios may be possible for ownerships committed to meeting conservation objectives in working forests. The perception that sustainable forestry can be a tool for conservation is driving this overall movement.

If our community's intention is to keep large blocks of forestland intact and under management that will sustain our economic and ecological future, then it is imperative to develop financial instruments and resources that enable managers committed to conservation objectives to avoid unsustainable levels of debt.

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### ***The ScoPac Valuation***

ISF commissioned the ScoPac valuation in response to environmental and non-industrial concerns about the viability of sustainable forest management in the current economic, regulatory and political climate. The ScoPac property was chosen as an example for several reasons:

- The sustainable management of the ScoPac properties as intact working forests is critical to both environmentalists and industry supporters.
- The potential for ScoPac bankruptcy and fragmentation is well publicized, and
- There is a high level of public information about the ScoPac properties from which to draw.

### **The Valuation Data**

The ISF valuation contains two potential cash flow models: “traditional timber” management and “community forestry” or long rotation selection management. Cash flow projections for the traditional timber model are based on an evaluation of publicly available timber harvest projections from the company’s SYP, HCP and SEC filings. Cash flows for the long rotation or “community forestry” model are based on modifications to the publicly available projections.

The valuation of the harvestable timber and the harvestable timberland of the 204,000 acres of Scotia Pacific (ScoPac) lands in Northern California was conducted at our request by Baldwin, Blomstrom, Wilkinson and Associates (bbwassociates.com) a local consulting forestry firm in Arcata, CA. Their appraisal and valuation is based on publicly available information including ScoPac’s 10K filings with the Securities and Exchange Commission, in particular their 10K filing of 10/27/05.

The consultants determined that the turnover of redwood timberland has been brisk within the last couple of decades. Based on analyzing ten sales of redwood land, and in particular three large sales ranging in size from 25,000 acres to 194,000 acres, all of which sold in the last six years, the consultants estimated the value of the ScoPac property as ~\$424,200,000

The consultants also looked at the income stream that the property might produce over the next 30 years if it were to continue to be managed as it is today. ScoPac projects an average harvest of 100 million board feet (MMBF) between 2006 and 2016. As a result of adjustments and projections the consultants believe that the actual harvest of 135 MMBF today would drop to 119.5 MMBF in 2009, and then drop further to 88.7 MMBF in 2019. Averaged over the next 30 years, the consultants estimated that ScoPac’s average yearly harvest would be ~ 103 MMBF/year. In addition, an annual harvest of 103 MMBF represents a harvest rate of about 504 bf/ac/yr, which is within the range of annual harvest rates of the other major companies on the Northcoast.

Based on estimates of the number of acres of loggable land, mix of logging systems, mix of silvicultural systems and assumptions about redwood prices today and in the future, the consultants estimate that the present value of the timber harvest from ScoPac lands would be about \$552,032,000 over the next 30 years.

Finally, we asked the consultants to determine how much revenue might be derived if the property were managed on a long rotation uneven-aged basis as a “community forest”. The consultants determined that as a result of conservative uneven aged management, inventory on the forest could rise from 3 billion feet today to around 4.8 billion feet in 30 years. Although harvest rates would need to drop over the next 15 years from 100 MMBF today to around 63 MMBF in 2014, harvest rates would begin to rise over time, until rates were around 100 MMBF in 2036 and could eventually reach around 150 MMBF in 70 years. The

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present value of the first 30 years worth of harvest would be about \$331,360,000 while the net revenue generated during that period, unadjusted for the time value of money would be about 1.3 billion dollars.

ISF recognizes that ScoPac’s proprietary inventory, growth and harvest projections may differ from this analysis, however we believe these projections to be reasonable and accurate based on the information currently available to the public. For a more detailed presentation of the assumptions and methodologies used to develop this valuation please visit [www.newforestry.org/council](http://www.newforestry.org/council)

### **The Implications**

ScoPac’s current debt structure presents a significant economic challenge for management and staff committed to sustaining ScoPac properties as a working industrial forest. It appears unlikely that the ScoPac will be able to pay down its existing bond obligations based on timber harvest alone – regardless of the forest practices implemented.

While environmental regulations may hinder ScoPac’s ability to meet debt payments, relief from regulatory requirements may not be sufficient to change ScoPac’s financial situation. Regulatory relief will do little to moderate intense competition in lumber and panel markets, reduce operational costs or increase standing inventory and growth rates on company timberland. Despite the best efforts of industry lobbyists and non-industrial groups like the *Buckeye Forest Project* it remains uncertain whether efforts to streamline existing regulations will be effective in the foreseeable future.

The data show that without significant changes in forest products markets, increased equity investment in the company to pay down existing debt and/or changes in the current political climate ScoPac management will have little choice but to continue to sell off forested parcels in order to avoid significant financial losses.

### **Consequences of Forest Fragmentation:**

#### **Increased residential land use: Environmental decline, eroding timber tax base**

Fragmentation of forest lands creates a self-perpetuating cycle where residential land use limits the profitability and the likelihood of productive timber management which then, in turn, leads to more subdivision and residential use. As free-standing working forest parcels are lost to development, issues arising from the resulting residential uses create further pressures on adjacent timberlands. The proximity of residential land use brings further scrutiny of forest management operations and often increased management costs. These increased costs create an unintended incentive for more intensive management and even greater scrutiny of timber operations. Ultimately, a tipping point is reached where the surrounding working forestlands become less viable as productive timberland and more viable as residential “estates.”

The resulting residential parcels are not subject to the same scientific and regulatory scrutiny as managed timberlands. Often poorly designed and poorly maintained residential access roads contribute greatly to sediment and erosion – decreasing water quality. Regular year-round traffic, increased residential water use, family pets, and residential garbage/compost all contribute to significant declines water quality and habitat for many native wildlife species – sensitive or otherwise.

Other consequences of fragmentation include declining timber yield tax revenues as lands used for large-scale timber management become “de-facto” residential lands. Often these

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types of conversions result in a small parcel paying residential property taxes and while the majority of the properties remain in TPZ, though with little likelihood of any future productive management. In such a case, the “tax deferral” of TPZ becomes a de-facto public subsidy of private residential property.

### Reduced timber supply: Industry decline

The ScoPac properties represent an important source of timber supply for Pacific Lumber Company (Palco). Fragmentation leading to subdivision, development and a reduced emphasis on timber production will reduce access to the timber supply necessary to maintain a profitable market share for Palco mills – and could ultimately threaten their economic viability – particularly during low points in industry business cycles.

The mills, in turn, represent an important sawlog market for non-industrial forest managers. Without sufficient timber supply to support local mills forest fragmentation could ultimately result the loss of local sawlog markets. Local log markets help offset the costs of fuels reduction efforts that decrease fire hazard as well as other pre-commercial and restoration management objectives. Without local log markets the option to manage working forests for any kind of commercial timber production will be severely curtailed placing increased pressure on landowners to consider the economic benefits of subdivision and development.

### Thinking like a community

Sustainable forest management issues impact many groups ranging from environmental activists to industry lobbyists. Objectives range from restoration and preservation to regulatory reform and intensive management. Cooperation between the far edges of the spectrum remains difficult; yet there is strong and growing middle that recognizes the environmental, social and economic importance of maintaining working forests on the North Coast.

The increasing impacts of climate warming trends, global economic integration, changing demographics and the increasing importance of clean water for both wildlife and humans make it clear: building the infrastructure, capacity, financial resources and policy instruments necessary to support conservation values in long-term forest management objectives is crucial to the future of Humboldt County, Northern California and the planet as a whole.

*This document was written and developed by a working group of the **Sustainable Forest Council**. The working group includes Greg Blomstrom, Chris Larson, Mark Lovelace, John Rogers, and David Simpson.*

*For more information on the Council, **Financing Sustainability – A Case in Point** or to download the summary and/or powerpoint presentation of **ISF’s Limited Appraisal and Valuation of ScoPac Timberland and Timber** please visit the Council’s webpage on the ISF website: <http://newforestry.org/council/>*

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