

February 2017

# Funding and Finance Problem Statement



## Overview

The goal of the Northwest Community Forest Coalition (“Coalition”) is to create the enabling conditions that will increase the extent and scale of community forests in the Pacific Northwest. Following the 3rd annual Community Forest Forum (May 2016), the Coalition’s steering committee resolved to explore the primary challenges to funding and financing land acquisition for management as community forests. This document is intended to be an internal resource that will be used by the Coalition to assess potential financing solutions, innovations, and potential policy initiatives that will increase community forest acquisition opportunities.

Primary finance and funding challenges identified by the Coalition include:

1. The high cost of timberland in the Pacific Northwest
2. Limits in the requirements, amounts, and goals of public and private funding for forest acquisition
3. The sensitivity of finding a balance between conservation and earned income to both repay financing and assure ‘working forest’-related benefits in the long-term
4. Transaction costs and capacity to close deals
5. The effort for overcoming strategic, stakeholder, and governance issues for effective advocacy

## Goals and Objectives of Community Forests

In practice, the goals of each community forest will vary according to local demand. Governance of a community forest distinguishes itself from a pure public- or private model by incorporating perspectives from communities of place, and communities of interest, into decision-making, access, and benefit sharing. Compared to public or private ownership, desired outcomes of community-level ownership include enhanced local influence in planning and decision-making. In the Northwest, community forests have been established by land trusts, towns, and community-based organizations according to their specific needs and goals. Community forests have a long history in New England, where municipal ownership of working forestland secures access to open space, jobs, and timber supply for each town. Private individuals or organizations that hold timberland in trust can also establish community forests by writing easements and management plans for public benefit.

## Timberland Price and Ownership Structure

The cost of timberland in the Pacific Northwest has reached historic levels and continues to rise. Western timberland has the highest value in the nation, with prices averaging \$2,465 per acre in August 2016. The average value of \$2,465 disguises a significant gap between west-side Doug Fir value at \$3,500 to \$4,000 and east-side, which can range from \$500 to \$1,500 depending on “Blue Sky” value. The growth in the value of the underlying land, and not the standing timber, now makes up an increasing proportion of

sales price and the rate of capital appreciation continues to outpace the increase in operating revenues from timber harvests.

Historically, integrated companies owned timberland in order to secure a fiber supply for their revenue-generating mills and manufacturing facilities. Today, timberland is the asset providing the return, and management planning has shortened the time horizon to better match investor expectations and fund structures. With Timber Investment Management Organizations (TIMOs) and Real Estate Investment Trusts (REITs) managing forestland as an investment, management's fiduciary responsibility to generate profits, rather than to secure long-term jobs, timber, and fiber supply, drives harvest and sale decisions. As a result, the past twenty years have seen increasing pressure to fragment properties into smaller parcels, including for development, according to their highest and best use.

Although some disagree about the ability of the market to drive further price increases, the influx of institutional capital seeking to hold timber- and ag-land continues to fuel competition for limited land. Timberland values are expected to increase in the near-to-long-term. A small number of mission-driven investment firms have pioneered innovative strategies to serve critical functions as either bridge entities or long-term land stewards. Despite this, community-based organizations may experience a gap between their local needs and regional or national priorities and capacity.

## **Limited Funding**

A continuing challenge is the ability to bridge the gap between a property's market value and the conservation value which creates a spread that is often "purchased" through public and philanthropic funding and various below-cost financing sources.

First, the federal programs specifically tailored to forest conservation fall short of meeting the goals of community forests. The Federal Forest Legacy Program, which may fund up to 75% of the cost of acquiring easements in a working forest, conveys the interest to a Federal, state, or local government unit. For community forests, such a transfer complicates the transaction, but may support the goal of increasing local participation in management decisions. If a community owns fee-title interest in the land and a federal agency owns the easement, there can be mutual benefit, and the easement assures that the non-economic values that are supported by some in the community are retained. In contrast, the Community Forest and Open Space Program administered by the Forest Service grants up to \$400,000 per project for fee simple acquisition by local & Tribal governments or non-profits. In a market where this amount may competitively purchase only 150 acres, the Community Forest Program offers only a slice of the funding stack.

Second, in the Pacific Northwest, auction prices tend to exceed a property's Federal 'Yellow Book' appraised value, which sets a limit on the basis used to calculate cost-share funding, and additional funding is needed that can bridge this gap. However, each new source of funding brings additional reporting requirements and possible encumbrances that increase the complexity of the deal. Possible solutions include lobbying for changed categories with eligibility under the Forest Legacy Program, fully funding and increasing the cap under the Community Forest Program, and cultivating new private and philan-

thropic donors.

## **Financing**

Conservation forestry can be challenging to finance under the prevailing economic conditions and commercial lending practices. Traditional financing in the form of commercial loans requires positive cash flows from earned income activities. Even commercial industrial forestry often struggles to match available harvest volumes with the expected cash receipts. However, conservation forestry practices promote longer rotations and larger buffers, which net lower timber revenues and require additional earned income to offset restoration activities. This creates an even greater gap between a forest's market value and its discounted cash flow. Longer-term, low-interest financing sources can be good solutions for vibrant communities with taxing authority. Here municipal bonds, New Market Tax Credits or a state's Clean Water Revolving Loan Fund can reduce the effective cost of capital.

Other opportunities exist to supplement earned income to repay standard financing. Oregon has passed legislation allowing for municipalities to form Community Forest Authorities to deliver low-cost municipal finance for forest acquisition. Washington State has authorized, but not funded, a Community Forest Trust program. Some organizations have succeeded in monetizing carbon or water payments from voluntary and compliance buyers, while others may need to log heavily in early years to repay bridge financing. While the movement towards impact investing promises to unlock new sources of patient, low-cost capital, actual activity remains scarce. One solution could be to build relationships and then match impact investors with active projects.

## **Transaction Costs**

Transaction costs, which can range from \$50,000 to \$1,000,000 depending on property size, represent a significant hurdle. Unlike organizations with a long history, healthy balance sheet, and strong brand, each group may struggle to establish their voice and gain a seat at the table. Many community groups lack resources to undertake the modeling, due diligence, check cruise, and legal work required to evaluate a site and prepare a competitive grant application. A secondary issue is that even if groups have funds, the seller may not believe the group can close a deal. In order to bid at auction, groups must show capacity to close a deal by verifying cash held in escrow. More practically, the community interest most often favors smaller purchases than those commonly transacting between TIMOs and REITs. The willingness of sellers to negotiate with conservation interests may also be limited to a time window shorter than the multi-year process required to plan across budget cycles and write grants. Winning federal funding can require strong relationships with agency personnel at the state and federal level. These challenges can be overcome through cooperation between community-based organizations and regional or national conservation groups with extensive resources and expertise.

## **Future Opportunities**

Despite a decade of efforts in the early 2000s and across a variety of geographies in the Southeast and Northeast, increasing the size and extent of community forests requires increased visibility and advocacy. The Northwest Community Forest Coalition is well positioned to advocate for solutions. By gathering stakeholder feedback, the Coalition could unite wide-ranging interests and represent conservation interests in state capitols across the Northwest. The Coalition could also provide a platform for western conservation in Washington D.C. Finally, the Coalition could increase the profile of community forests among high net worth individuals and foundation staff in order to attract increased philanthropy. Significant interest exists among Coalition members to build relationships between prospective investors and community organizations. Organizing stakeholders to capitalize a Northwest Community Forest Fund might enable strategies such as i) acquiring scattered parcels to swap for private or public lands, ii) participating in auction and/or quickly responding to willing sellers, and iii) decreasing transaction costs by sharing capacity.

## Notes

Definition: a 'community forest' offers an alternative to public or private & industrial ownership models that: Secures access and rights to the forest resource at the community level; Promotes community participation in management decisions; Ensures that communities receive value and benefits from the land that can support and reinforce community priorities and economic development objectives; and Secures permanent protection of the conservation values of the forestland.

## Links

i [https://northernforest.org/images/resources/community-forests/Community\\_Forests\\_Report\\_1.7MB.pdf](https://northernforest.org/images/resources/community-forests/Community_Forests_Report_1.7MB.pdf)

ii <https://www.campbellglobal.com/education-research/view-timbertrend-document/170>

iii <http://www.fs.fed.us/cooperativeforestry/programs/loa/flp.shtml>

iv <http://www.fs.fed.us/cooperativeforestry/programs/loa/cfp.shtml>

v <https://www.epa.gov/cwsrf>

vi <http://www.communitiescommittee.org>

vii <https://northernforest.org/resources/community-forests>

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