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Timberland investing: Selling timber rights is another way to skin a cat

By Curtis Seltzer

A number of timberland owners now find themselves in a pickle like this: They need to get some cash out of their timberland, but don't want to do any of the following:

1. Sell their timberland as a whole in a down market;
2. Refinance their timberland to pull out cash, assuming some equity exists in the property and a refi can be secured at reasonable terms;
3. Divide and sell a portion of their timberland; or
4. Sell their stumpage at current prices.

So what else can they do to find some cash in their timberland?

Depending on the specifics and the circumstances, what might work for this timberland owner is to arrange a cash sale of his timber-cutting rights for a specific number of years to a buyer who has the ability to wait for a market upturn.

The difference between a conventional sale of merchantable timber and a sale of the timber rights is the length of the cutting window. For smaller tracts, a timber buyer usually requires a 12-to-18-month window. Sale of rights, however, might extend for five years or more.

The advantages of a rights sale to the landowner are several.

First, the timberland owner raises cash, the amount of which, of course, will be determined by the volume and characteristics of his merchantable timber during the cutting window and the buyer's estimate of future market conditions.

Second, the timberland owner retains ownership of the land. His asset has been used to get him over a rough spot. Some of its renewable fair market value will be removed at some future date, but the land is still in his portfolio and capable of generating future income from timber sales, land sales and other means. If a large part of the timberland's value resides in its Higher-and-Better-Use quality, I would not recommend a clearcut or a severe dimensional cut that would eliminate the property's HBU appeal. A lighter harvest can preserve much of the HBU value. Sometimes, of course, the hardest choice is the easiest because all the alternatives are worse, and you realize you have no choice except the hardest one.

Third, the timberland owner can tweak the amount and type of cutting sold to fit his immediate cash needs.

Fourth, the risk of the property's timber value eroding further is shifted to the buyer during the term of the sale.

A timberland owner needs to enter into a rights sale with a full understanding of what is being done and its consequences. He needs to have a current cruise in hand before entering negotiations with a timber-rights buyer so that he knows what he is selling and its current market value. He needs to understand how the exercise of the rights he is selling will affect the look of the property, its future timber value and its overall future market value.

The owner's consulting forester should be thoroughly involved in conceptualizing and implementing the sale. The owner's lawyer and tax adviser should also be brought into the loop prior to making a deal.

The buyer is coming up with present cash for the expectation of future reward. In part, he's betting that the stumpage market will trend up, eventually and within the sale's term. In part, he's controlling his vulnerability to future uncertainty by buying low enough that he believes he will come out ahead within the cutting window.

The owner will try to stick to the current cruise value of the merchantable timber as the sale price. The buyer will try to get a deal that knocks that price down, up to 50 percent. The buyer argues for the discount, because he is assuming all the risk in the deal and is losing the income-earning value of the cash he's paying to the owner. A 25 percent discount off current cruise value for a 10-year rights sale might work for both parties.

The parties might also agree to a buy-back provision, which allows the owner to repurchase his timber rights for a fixed price during the term. That price will be high enough to compensate the buyer for his investment.

Neither buyer nor seller should enter a rights sale without a consulting forester on his team.

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