

New Hampshire-based "Trust" not too trustworthy Strategic Timber Scam

by Jennifer Poole

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"Psst. Hey, buddy... You want to buy some hot stock in a timberland deal? The stuff is really good, man: premium second-growth redwood and Douglas fir. We're ready to move it, too. We're gonna cut 30 million board feet this year alone on 79,000 acres we bought last year in Mendocino and Sonoma counties. And that's just the beginning."

This pitch sounds good to the unsuspecting stock buyer, eager for the quarterly cash payments described in the prospectus for a \$332 million stock offering recently filed with the Securities and Exchange Commission by the "Strategic Timber Trust." Trouble is, there just plain aren't 30 million board feet available for harvest on the two pieces of county forestland STT is talking about.

The 15,000-acre Willits Woods and the 64,000-acre Longview Tract, both owned until last year by Rich Padula's Coastal Forestlands, Ltd., have "a long history of timber production," as the California Department of Forestry politely puts it.

In fact, one VIP in the local timber industry said he thought it would be "a real stretch" to cut more than 3 million board feet a year from those lands. The discrepancy between the rosy picture painted by the stock prospectus and the reality on the ground came to light thanks to Alan Levine of the Coast Action Group. In a letter Levine sent to the SEC, he pointed out that the Option A harvest plan filed with CDF for the property claims an average of 6,500 board feet of conifers per acre, while the prospectus claims more than 10,000.

The STT prospectus also says there's a total of 856 million board feet of "merchantable timber" on the two tracts, collectively known as "the Coastal Forest." (Or a total of 839.2 or 886 million board feet, depending on which page of which version of the prospectus you've got in front of you.) The Option A document, however, shows a total of only 580.3 million board feet of timber, and nearly a fifth of that is tanoak and other hardwoods not considered highly "merchantable" these days in California.

True, it's been a couple of years since the inventory figures in the Option A plan were put together, and young forests (such as these are) do grow quickly but not that quickly. Besides, the logging has continued. According to CDF's Tim Robards, the 1998 average figure for conifers per acre in the Coastal Forest, adjusted for growth and harvest, was 6.84 thousand board feet.

More importantly, according to Robards, because of questions about the accuracy of the Option A growth estimates to begin with, CDF approved the plan with limits on the acreage that could be logged annually, not just limits on the board feet that could be taken. Under this Option A

plan, harvesting is only allowed on 10% of the Coastal Forest lands each year. If STT can't find the total volume it's allowed to log on 10% of its acreage, too bad -- and it's not very likely it will, considering how few big trees remain on the property.

"There's not a lot of what we call 'sweet spots' out there," Robards said. There are also questions about the claimed commercial value of the trees that are growing in the Coastal Forest. The STT prospectus frequently identifies the majority of the trees as "second-growth" redwood, commanding a premium price in the marketplace. (They even define the term in their glossary as: "redwoods that have been replanted after the original forest was harvested").

The redwoods now growing in the Willits Woods and the Longview Tract are not second-growth trees. They could be described as "fourth-growth," maybe "third-growth" or even "fifth-growth."

"We're talking about 20- to 30-year-old trees," said Mendocino County forester Steve Smith. "It would take 100 of them to fill a logging truck." Smith was hired a couple of years ago by the county's Forest Council to help evaluate the sustained yield plans major timber companies were required to submit to CDF after the state Board of Forestry turned down Mendocino County's request for local logging rules.

"This is one of the biggest red flags I've seen since I've come to the county," Smith said. "I've dealt with a lot of ugly issues, but this is the ugliest I've seen. When you're dealing with good or bad forestry, that's one thing, but this is another thing." Levine, too, has harsh words for what he considers a "criminal" effort to work over these depleted timberlands yet again and to fleece prospective investors.

The stock offering is being handled and underwritten by well-known Wall Street investment giant Salomon Smith Barney.

"It's sort of a bastardization of the OK,-anything-will-sell,-the-stock-market-is-booming' concept," he said. "What are they going to do with all these timberlands they can't do anything with? They'll put them in these trusts and sell them to people who don't know what the hell is going on. This used to be the best-growing timber production land in the world," Levine said. "The Amazon doesn't grow stuff as fast. What's out there now is only 5% of the original standing board feet on the ground, before the white folks got here... which is also probably the same amount of fish that are left in the rivers."

Levine also pointed out what he called the "outrageous assertion" in the original prospectus that the property's terrain "ranges from flat to steep slopes."

The Willits Woods is located west of Highway 101 and south of Highway 20, and has been described only half-jokingly as "a canyon." The Longview Tract stretches from north to south a few miles inland from Point Arena down to Stewarts Point in Sonoma County.

No significant portion of these lands is "flat"; the Option A document describes both tracts' terrain as ranging from "moderate to steep."

It would be funny except the original prospectus went on to say that, due to the flatness of the terrain, "a significant portion of the property is available for harvest using ground-based systems,

a condition that is unusual for coastal timberlands in California."

"They want to use feller bunchers," Levine said, "big machines that scoot up to the trees and whack a whole bunch at the same time." Logging with ground-based systems is cheaper than helicopter logging or cable systems, and the original STT prospectus cites the cost savings from ground-based logging as one reason why they expect to be financially successful.

(All of these comments about the terrain, by the way, are missing from the most recent version of the prospectus, filed with the SEC on March 26. The new prospectus does have more language warning of possible restraints on logging due to environmental laws, i.e., endangered species regulations. But it certainly doesn't mention that the state Department of Fish and Game just took the unprecedented step of closing more than 30 Northern California rivers to fishing for eight weeks to protect steelhead salmon. Three of those rivers were Big River (which runs through the Willits Woods) and the Garcia and Gualala rivers (which run through Longview).

But the "most fraudulent" statement in the STT prospectus, according to Levine, "is that they have a permit."

The Option A plan for this property was indeed approved by CDF last summer, but it is not a permit to log. First, under any Option A plan, timber owners still need to get a timber harvest plan OK'd for each logging operation. Second, as far as CDF is concerned, this particular Option A plan is at present only conditionally approved.

According to Dean Lucke, assistant deputy director for Forest Practices, CDF is "still trying to validate (STT's) current Option A inventory figures. They're late with monitoring reports that were due March 1." The monitoring reports are supposed to confirm that the trees are growing and the inventory increasing at the rate estimated by the plan. According to Levine, it's no surprise that the reports are late: "The test plots are missing where they're doing their monitoring," he said. "I think somebody cut them down."

Without proper validation of inventory growth, Lucke said, "We're not going to process anything." CDF's Robards confirmed that the inventory monitoring plots set up in 1995 had been logged. "They used knitting needles to mark the sites," he said. Usually, monitoring plots are marked with rebar, and maybe even piles of rocks and orange paint. "It's a tradeoff," Robards said. "You don't want to make the sites too obvious, because then the loggers will treat them specially, and they won't represent the true state of the trees. But these got trashed."

Robards also said the Option A plan was further limited by required monitoring of the "clean and release" hardwood control program, which is supposed to get rid of tanoaks that dominate cutover forestland so conifers have a chance to grow. Often, timber companies use herbicides to kill the tanoak, but Coastal Forestlands did not have a history of herbicide use, and tanoak eradication on these lands has been done manually.

However, Robards said, reports he's gotten so far on conifer growth in the "clean and release" areas indicate that "it's not working" and the redwoods and Doug firs are not growing at the rates the plan projects. He is scheduled to go out and inspect these areas sometime in May.

All of these attempts by CDF to validate the Option A figures will be "impossible," said county sustainable forestry expert Hans Burkhardt, author of the book, "Maximizing Forest Productivity."

"Coastal Forestland's gross data was not credible," he said. "The plan's claims of average growth are more than five times higher than CDF projections of the average growth for Mendocino County's industrial lands."

"Their land is definitely inferior to that of G-P or L-P [now the Mendocino Redwood Company]," he continued, "but the board feet per acre they claim they will grow is much higher. If G-P and L-P would have the same phenomenal growth, we would have neither a timber supply nor an inventory restoration problem, since only 25% of production would be removed by harvest."

Although CDF officials have so far been close-mouthed about their opinion of the STT prospectus, that may soon change. A letter from Mendocino Forest Council staffer Greg Giusti was sent to CDF's Sacramento office on March 31, asking the agency to "answer some questions" about concerns raised by the discrepancies between the two documents.

"The allegations raised in the letter from the Coast Action Group are very serious in nature," Giusti wrote, "and the MFC [Mendocino Forest Council] is very concerned about the ramifications if in fact the letter is accurate."

At the Forest Council's March 29 meeting, where Levine's letter was discussed, members also read a letter received from Mason, Bruce & Gerard, the forestry consulting company that did the inventory estimates for both the Option A plan and the STT prospectus.

The letter claims that the discrepancies came about for two reasons. First, MB&G's Glenn Zane writes, STT bought an additional 4,400 acres that weren't included in the original Option A acreage, thus increasing the inventory.

In fact, that extra land doesn't make up for the 6,300 acres the Option A document set aside from the total acreage used to calculate inventory estimates -- acres that were not deducted from the total inventory figures presented by STT in its prospectus. Three thousand of those acres simply don't grow trees; 3,300 of them are "constrained" from logging, i.e., they're "wildlife protection zones" or buffer zones around streams, etc. The second reason Zane cites for the difference in inventory figures is that for the STT inventory update, MB&G used a different scale to measure trees that were big enough to log.

"The Option A merchantability standards," the letter reads, "included as 'merchantable,' logs with a minimum small-end diameter of 6 inches and trees that would produce at least one 16-foot log." This is the standard Scribner measurement scale used throughout California. The updated inventory calculations, Zane writes, consider merchantable trees as those that have a "minimum small-end scaling diameter of 5 inches (4.5 inches +) and a minimum piece length of 12 feet."

In both the Willits Woods and the Longview Tract, Zane writes: "Stocking in the small-diameter

classes is very high in proportion to the larger diameter classes," and so by counting even smaller trees as ready to log, there was a "substantial" increase in volume of "small trees that had been excluded formerly."

When asked at the meeting if these explanations took care of his concerns, county forester Smith said simply, "No."

One last example: To explain why past financial data from logging on these two tracts wasn't included in the prospectus, STT claimed the data was irrelevant because the lands "were managed in a substantially different manner by the prior owners than we expect to manage them."

"The previous owners," the prospectus continues, "held these timberlands primarily to seek capital appreciation. Harvests were conducted at relatively low levels with the objectives of thinning and extraction of hardwood species from softwood tracts. We expect to increase substantially harvesting and revenues from the Coastal Forest as compared with historical results."

Anybody familiar with the history of these timberlands would doubt this statement. CFL's Padula has a widespread local reputation as a man who likes to cut trees. His logging philosophy was described by one local forester as: "There's no way in hell any tree should grow greater than 16 inches." Indeed, total board feet logged from the Coastal Forest was probably less in 1997 and 1998 than in earlier this decade, although precise figures aren't available for those two years. In 1996, 18.8 million board feet was logged. Levine estimated that no more than 9,000 or 10,000 board feet was cut each of the last two years, saying that CFL had a hard time getting THPs approved after the watersheds where these lands are located were designated as "water quality impaired" under the Clean Water Act.

This designation triggers a requirement to establish "Total Maximum Daily Loads" (TMDLs) or limits on soil sediment entering the rivers from logging activities. Robards agrees that CFL had recently had problems getting THPs OK'd. "I wasn't intimately involved with this," he said, "but I know they ran into TMDL issues, which held up a lot of THPs."

So, just what is the "Strategic Timber Trust," and how did it come to own the Coastal Forest? A little history may shed some light on that question. According to CDF, the Willits Woods has been logged continuously since the early 1900s. The Longview Tract was first cut over in the 1950s and 1960s, and then left mostly alone between 1970 and 1988, when "harvest activity increased."

Coastal Forestlands bought both pieces in 1992, and then sold the property to the Oregon-based Pioneer Resources in July 1998. According to the prospectus Pioneer paid \$130 million for the property, working out to about \$1,650 an acre. Pioneer then turned around and "sold" it to STT three months later, for \$35 million in cash, paid at the time, and the promise of more cash and stock after this current stock offering is successfully concluded.

After all is said and done, Pioneer, along with the 366,000 acres of timberlands it owns in the Pacific Northwest, will end up as a wholly owned subsidiary of STT -- or technically of a

Delaware-based operating partnership called "Strategic Timber Partners."

(Pioneer's California timberlands also include the "Commander tract," approximately 43,000 acres Pioneer bought from Louisiana-Pacific in 1997 for \$25 million. Commander, which is located entirely within the Mendocino National Forest, straddles Mendocino, Glenn, Tehama, and Lake counties. According to several reports, it is being logged heavily right now, with little public or agency scrutiny. In the prospectus, STT says it expects to sell 17.4 million board feet of timber from Commander to Sierra-Pacific Industries this year. But that's another story...)

STT was founded in April 1998 by C. Edward Broom and sons of New Haven, New Hampshire who, along with two other principals, have "participated in a series of timberland investments in the United States, Latin America and New Zealand for 10 years." Their first deal as STT was to borrow \$210 million to buy 88,000 acres of timberland in southwest Louisiana. Altogether, through a complicated, revolving process, STT has borrowed \$509.4 million "to acquire our timberlands." They plan to pay back the debt with the proceeds from the stock offering and an additional \$260 million loan.

The Broom family will hold nearly \$24.5 million worth of stock after the initial offering is concluded. C. Edward Broom is making a salary of \$225,000 this year as CEO of STT, with an anticipated \$150,000 bonus, and his sons will each make \$131,250 plus the same bonus.

The prospectus says that after all the post-stock offering transactions are finished, public shareholders will own 96.1% of STT, and "continuing investors" will own only 3.9%.

STT is not the only company trying to set up a "real estate investment trust," or REIT, for timberland. According to a March 23 Wall Street Journal article, STT is one of three companies in line to become publicly traded REITs. But, the story says: "It isn't clear whether any of these proposed timber REITs will ever make it to market."

Two weeks ago, Plum Creek Timber, one of the nation's largest timberland owners, postponed a vote to convert itself into an REIT, because of a complaint filed by an investor who wanted more information on the conversion. And one analyst quoted in the story didn't think traditional real estate investors would go for the volatility of an asset whose value was based on the lumber market.

What happens if the stock offering fails, or timber revenues don't satisfy the public investors? Well, there's always the option of trying to sell the land off for subdivisions or vineyards.

In its prospectus, STT claims that "most of the Coastal Forest is productive timberland that the company intends to continue to manage for timber production." However, "a portion of the property is suitable for use as a vineyard, and the company is working with a former owner of the property to permit it to acquire this land [at \$2,000 per acre] for development of a vineyard."

On another page, the document states: "Some of our timberlands may have greater value if used for ranching, farming or recreational purposes or for residential or commercial development. We will sell these properties to others when it is in our financial interest to do so."

Currently, according to the prospectus, STT has identified more than 15,555 acres from its

Oregon timberlands that could be sold for a "higher and better use than growing timber."

"This is a real threat to the county's private timber lands," wrote county forester Smith in his letter alerting the Forest Council to his concerns. "Sustainable forestry requires the debt of the land not to exceed the stock. This REIT is not sustainable and is against all principles that make timber production a desirable element in our community.

"As noted in the filing papers," his letter continues, "these lands may go to other 'higher and better uses' -- and will -- to meet an obvious financial demand once the expected volume is found to be unavailable. If this public offering is successful in making profit for a company where there is no available stock, how soon will other landholders do the same?"

(The STT prospectus is available for viewing on the world wide web at:
www.sec.gov/Archives/edgar/data/1062013/0000950144-99-003239.txt)

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