

Investing In Vermont Forestland

by Kurt Zschau

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As stellar stock market and real estate returns become a distant memory and the reality of today's challenging economy and lower investment returns takes root, more investors are seeking safe, stable returns with less risk. More investors also seem to be placing more emphasis on the social and environmental implications of their investments. If anything best captures all of these attributes, it may be investing in forestland.

Those looking to buy forestland in Vermont can be divided into two broad categories: 1) individuals or families making a lifestyle choice and 2) investors. The lifestyle buyer's decision to purchase is usually based on a desire to own a small woodlot, perhaps to live on, and at any rate to manage for recreation, wildlife habitat, firewood and periodic income, with the latter having much less weight than the other goals. These buyers generally focus on smaller acreage lots.

The investor purchaser is looking for stable financial returns over a fixed period of time. The investor category is largely made up of legacy/family investors, logging/sawmill businesses, Timberland Investment Management Organizations (TIMO), pension funds, sovereign wealth funds and Real Estate Investment Trusts (REITs). Since economy of scale is a critical element to investment returns, these buyers tend not to purchase land under 250 acres.

While the evidence is somewhat anecdotal, the legacy/family investor appears to be the most active buyer type in Vermont right now. This buyer often views a forestland investment over a longer time horizon than the other investor types. While closed-end fund investor groups generally hold forestland for between 10 to 15 years, most legacy/family investors have at least a 20-year horizon and, in some cases, a multi-generational time-line.

For any purchaser of forestland, there are other significant but often overlooked "returns" to society from the working forest, including clean air and

water, habitat for wildlife, recreational pursuits and jobs. While these factors do not offer direct financial return to the investor, they do speak to the benefits that this investment has in the social and environmental context.

The inventory of forestland properties for sale in Vermont has remained fairly stable in recent years, and there is a good balance between supply and demand. Prices for forestland may have dipped a bit in the last few years after rising steadily for the prior decade, but in general values for bare land have held up quite well in Vermont compared to other types of real estate – and especially compared to other parts of the country.

Per-acre prices for Vermont forestland can vary widely depending on a number of variables, but prices are generally driven by an individual property's "highest and best use," or the most likely use for the property.

A parcel's highest and best use will often correlate to its size; one to 20 acre parcels are generally seen as house lots and trade for high per acre prices; 20 to 100 acre parcels are often viewed as recreational or larger homestead lots, trading at a slightly lower price per acre. However, prices in this range are often driven by how much a buyer planning to build figures he or she can afford for a lot given the expected costs of house construction.

Larger parcels of 100 to 200 acres begin to cross a threshold, becoming a more blended asset. These properties can have good timberland fundamentals but still have value assigned to the parcel's home or estate potential. As the acreage increases above 200 acres and the highest and best use becomes "forestland," price per acre comes down, with no direct correlation to the per acre values of the smaller categories. Total price in the largest category is typically driven by timber value as well as some amount of "bare land" value.

Log values hit a peak in 2005, then dropped significantly. Timber is a cyclical market, however, and we are now starting to see timber prices move higher again. The products derived from Vermont forestland, primarily hardwood sawlogs, are highly regarded in the regional and global marketplace. Vermont is synonymous with high quality sugar maple and yellow birch logs.

While our growing season is shorter than many other timber regions around the world, a short growing season, among other environmental factors, creates stable, beautiful wood grain. The dormant season also plays a great role in mitigated potential pest outbreaks. Many pest species cannot survive the long, cold winter here.

There are a few fundamentals that play into forest investing: physical growth of the trees, ingrowth of trees, and forest management strategies. All trees in a forest, whether intensively managed or left to grow naturally, exhibit physical growth and ingrowth; small trees grow to be big trees and enter into more valuable product categories as they grow. Species composition, stand age and diameter distribution all play into the timing of cutting cycles; however, average intervals between thinning harvests in hardwood stands can be 12 to 15 years.

In a natural forest condition individual trees are either well positioned to grow into a dominant component of the stand or are out-competed early in their life cycle. Some factors that contribute to whether a tree maintains its vigor or will slowly succumb to competition include micro-site conditions (soil), tree physiology or a natural disturbance.

Ingrowth, when a tree moves from a smaller to a larger product class, can have a significant positive impact on the value of that tree – depending on its stem quality in the early stages (e.g. poorly formed poles only grow into bigger pulpwood over time.)

Rather than rely on the slower natural process of physical growth and ingrowth, the landowner often hires a forester to manage the forest more efficiently. A forest manager will carefully consider the existing forest condition and landowner goals, and then match the most appropriate silvicultural prescriptions to meet those goals.

Silviculture, in many cases, will mimic natural disturbances but increase the frequency of the mimicked disturbance. The forester is likely to position these “disturbances” in the stand where there is a higher stocking of more commercially valuable trees. While this may appear that the forester is hitting nature’s “fast forward” button, tree growth is still slow. Anyone investing in forestland, even those planning to use intensive management, needs to appreciate the importance of patience.

In addition to forest management activities, investors may identify other opportunities to increase the investment potential of the forest. Some identify subdivision opportunities or attempt to trade carbon credits, while others may try selling a conservation easement to a conservation group.

There is an increasing component of the forestland investor pool that has an aversion to assigning significant value to subdivision opportunities. Whether this is due to the general malaise in the real estate market or a fundamental shift toward green investing remains to be seen. However, one tool used to mitigate this concern is the use of conservation easements.

In certain cases, easements are already placed on the land, lowering the financial barriers to acquire larger tracts of forestland. In other cases, forestland investors will identify a property that may have certain compelling features attractive to conservation groups, whether those features hold some ecological significance or other public benefit.

Conservation easements remove most or all of the future development value of the forest, limiting future management decisions (and future income) to the productivity of the forest itself. Many working forest easements have proactive forest management language but maintain a high degree of stewardship oversight with respect to silvicultural decisions. Any landowner looking to purchase conserved forestland or sell or donate an easement should engage the conservation group and their forester to fully understand the forest management implications.

Vermont Property Owners Report has previously published many valuable articles that explain Vermont’s property tax structure, current use program, capital gains tax, land gains tax and Act 250, so this article will not address these topics in detail. However, anyone looking to buy land in Vermont should understand these issues and determine how they may impact an investment decision.

Any qualifying forestland or agricultural land with sufficient acreage can be enrolled in Vermont’s Use Value Appraisal or “current use” program. The purpose of the program is to ease the property tax burden on those qualified lands that are enrolled and whose owner agrees to follow an approved forest management plan.

The Vermont land gains tax is a tiered tax that is levied on the gain of any land sold within a six-year period. There are certain exemptions to the tax but the premise of the tax is to prevent the speculative subdivision and “flipping” of land. Since most timberland investors hold land for greater than six years, this tax often has no impact.

As with any investment or large purchase decision it is important to do your research. With timberland, it is important to have a professional forester representing your interests. In addition, using an attorney and tax professional well versed in timberland acquisition is critical. A carefully hired team will be of immense benefit and will provide valuable information.

Whether you are looking to buy forestland as a lifestyle decision or diversifying an investment portfolio, a well-managed forest parcel can have measurable financial benefits as well as immeasurable environmental benefits. Before placing money in any investment, however, you should always consult with a qualified financial advisor. ■