

SOCIALLY RESPONSIBLE INVESTING / TIMBER

“More than mere producers of pulpwood and saw logs”

Leif Olsson, Managing Director and CEO, Ecotrust Forest Management, Inc. shares his views on how forests can be managed for both timber production and conservation

Is it possible to accomplish socially responsible investing and still provide consistent, low volatility, returns?

I believe a timberland fund can be managed in a socially responsible manner, such that it contributes to conservation and restoration, while still being an unparalleled investment opportunity. This goal is actually achievable, if one were to embrace disciplined, selective logging practices that ensure continuous forest cover. It is also important to educate investors to recognise that both from an environmental and return perspective, a myopic approach – ie logging timberlands to payout short term dividends, detracts from the ability to optimise a timberland potential returns (cumulative cash flow generation over a longer cycle of say 10 years). Of course, trees need to be felled to maintain a healthy forest, but this distinguishes itself from being required to fell, to secure short term cash flows.

Further by managing forests on longer rotations and thus with greater timber volume on the landscape, one sequesters significantly more carbon on the land than landscapes being managed under the current industrial regime. In fact, our estimates based on initial analyses indicate that our fund's lands will sequester an additional six metric tons of carbon per acre, per year - a total of over three million metric tons of carbon over the first twenty years for a 25,000-acre forest. At a projected price of USD5 per ton, this asset has the potential to generate significant returns for investors.

Why is the approach you take different? How do you access and quantify returns?

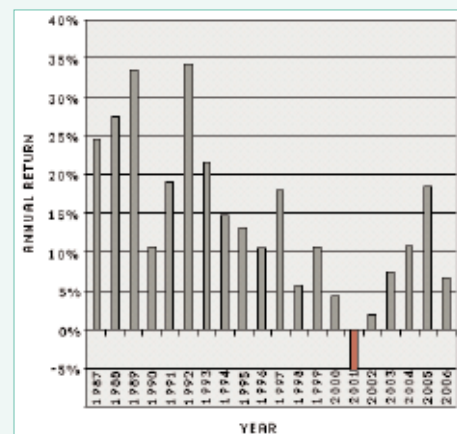
The purpose of a fund like ours is to acquire forestlands in the Pacific Northwest - we will protect sensitive environmental features, create local economic opportunities; restore watershed health and produce long-term value for investors. We target a real annual return of at least 6 percent over the long term and strive to be as tax efficient as possible. Our fund aim's to minimise ordinary income by maintaining long-lived forestland assets that continuously increase in value, hedge inflation and generate cash returns.

We estimate that logging and underlying appreciation will yield a 5–6 per cent real annual return, while conservation easements and other revenue streams will yield an additional 1–3 per cent, for a total projected annual return of 6–9 per cent before inflation. Historically timberland investment returns are comparable to those of the S & P 500 but at lower risk. Since the tracking of timberland investments began in 1987, average annual returns have been 14.4 per cent. In recent years returns have declined, and were negative in 2001. We believe that timberland investing will continue to produce low-risk returns, result in a negative beta compared to other investments and generate a return above that of long-term bond yields.

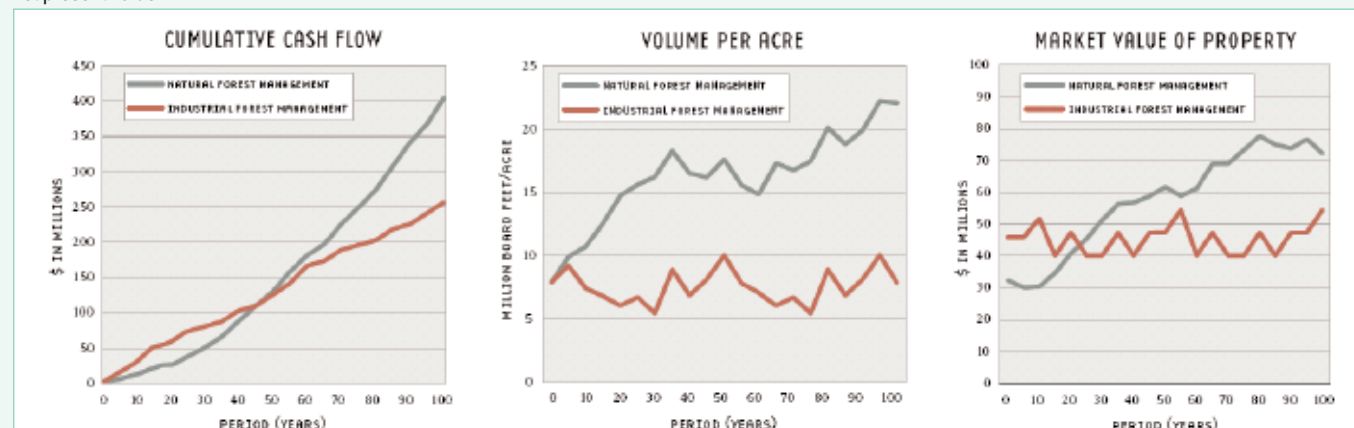
Why isn't it just "lip service"... and how does the fund implement and achieve environmentally friendly investing?

A fund like ours employs practices consistent with natural forest succession. These practices encourage a diversity of native species, age classes and forest structures. Logging has been refined to mimic natural patterns of disturbance that optimise natural regeneration, lengthen rotations and minimise the need for chemical fertilizers and herbicides. We marry science and technology to support rather than replace nature's energies - this helps us reduce the overall costs of forest management. The risks associated with epidemic levels of insects, disease and fire, as well as exposure to environmental regulation and litigation are also curbed.

So, if one compares our fund's approach (natural forest management) to an industrial approach for a typical forest in the Pacific Northwest region, our analysis and research show that over a period of one hundred years, natural forest management produces a greater cumulative timber harvest and more cash flow while resulting in a significantly more valuable forest. The industrial approach results in higher harvests in the early years and thus, using a discount rate of 7 per cent, a higher net present value.



NCREIF Timberland Index US Annual Returns 1987- 2006
 Source: Ecotrust Forest Management



Source: Ecotrust Forest Management

Assuming that a fund like ours was successful in selling the other benefits that natural forest management provides (greater carbon storage, enhanced habitat, better recreational opportunities and more scenic value) then, the net present value of our management is expected to be higher than the industrial model.