VALLEY buzz

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Capitalist and Conservationist

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Hanover -- There's a familiar storyline in the world of land investment that pits the conservationists versus the capitalists.

They are opposing forces engaged in a knock-down, drag-out fight for the rights to a chunk of the Earth. Conservationists say it is a precious natural resource, possibly home to rare species of animals and plant life, and should be preserved for future generations to enjoy. The capitalists, meanwhile, say its value as timberland and as a site for future development cannot be ignored. It will bring money to the area and jobs, and in a sluggish economy like this one, that's what's important.

In the end, there is no compromise. Development proceeds unchecked or is halted altogether. There is a winner and a loser. Depending on your perspective, the drama is either a tragedy or success story.

This is not a storyline to which Peter Stein necessarily subscribes.

Stein, 57, of Norwich, is a managing director at Lyme Timber Co. in Hanover, where his job is to play the part of both conservationist and capitalist. (The other managing directors are Jim Hourdequin of Hanover and Tom Morrow of Norwich.)


Peter Stein, a managing director at Lyme Timber Co., during an interview last week at the company's Hanover office. "I didn't join Lyme Timber to go build shopping centers somewhere," he said. "I joined Lyme Timber because there was a pretty clear pathway to harness private capital and devote it to conservation." **(Valley News — Geoff Hansen)**

Lyme Timber invests in timberland throughout the United States. As a for-profit entity, it is naturally motivated to make money. But the company balances that with a commitment to sustainable management and conservation. It believes there is value in *protecting* land from development, too.

"I didn't join Lyme Timber to go build shopping centers somewhere," Stein said in a recent interview with the *Valley News*. "I joined Lyme Timber because there was a pretty clear pathway to harness private capital and devote it to conservation."

Since the company's founding, in 1976, Lyme Timber has pursued timberland investment by partnering with nonprofit conservation organizations or government agencies, buying forests and selling easements -- a legal right to use property that you don't own.

Some of the company's investment return comes from timber harvesting, but just as much of it comes from conservation initiatives.

In the past two decades, Stein has inked more than 100 of these kinds of deals.

Stein was recently named the 2010 Forest Champion of the Year by the Pacific Forest Trust, a nonprofit land conservation organization on the West Coast. In December, he also received the Bridge Builders Award from Partners for Livable Communities, another nonprofit that promotes quality of life, economic development and social equity.

Stein hasn't always been in the private sector. Before he joined Lyme Timber, in 1990, he was with the nonprofit Trust for Public Land, a national organization based in California that works on land conservation issues. The Trust heads up park initiatives in cities and suburbs, protects farms and forests to preserve rural areas, safeguards historical sites and tries to ensure clean drinking water.

Roger Krussman, the state director of the Trust for Public Land in Vermont and New Hampshire, said Stein has been at the forefront of the trend toward private-public partnerships in timberland investment.

“He was one of the few people who took this idea to a level that it hadn't been at before,” Krussman said last week.

Stein sat down recently with the *Valley News* to talk about his job at Lyme Timber, why he thinks public-private partnerships are important to conservation efforts, and just how preserving nature can be good for investors' bottom line. What follows is an edited transcript of that conversation.

Valley News: So, 20 years later, how does it feel to be a cold, heartless capitalist?

Peter Stein: It's OK. I'm getting used to it. … I spent a wonderful period of my life working at the Trust for Public Land and I'm sort of personally dedicated to land conservation. … (This) was a way to change the behavior of private investment capital with respect to timberland. You could (A) make a return on your investment and (B) conserve a lot more land. The notion that my experience with the Trust for Public Land could essentially be married to the economic return requirements of private investors in such a way that they receive an economic return and the land was conserved through the use of working forest conservation easements was really something we pioneered here.

Prior to 20 years ago, or 15 years ago, working forest conservation easements were done by families for income tax deduction and estate tax relief purposes. They were done on a much smaller scale, kind of a boutique-y thing to do. And it really is only the last 12-15 years that … whole watersheds are being conserved using that technique. …

Forestland conservation was sort of black and white up until 15 years ago. If a conservation easement went on a piece of forestland, it usually meant that the forest couldn't even be harvested. It was a forever-wild easement. So it was a habitat protection easement or preservation easement. And really, it's only the last 15-16 years that this notion of keeping the land working, keeping the economic utility of the land going through ongoing timber harvesting activities could be a routine right, an ongoing right of the private landowner. …

VN: Why do nonprofits, why do state agencies even need private capital (to do this)?

PS: Couple reasons. One is the nature of the interest in land … if you have a private landowner who doesn't want to sell a conservation easement, but you have a public agency who wants to buy the conservation easement, you have to replace that private landowner.

So, Lyme Timber's role has been to be essentially the new private owner of property and give our land trust partners sufficient time to aggregate the public dollars to purchase an easement.

We're not at all necessary if the current owner says, Well, that's fine. I'll give you three or four years and you can buy a conservation easement once you aggregate the federal funding, the state funding or some philanthropy, whatever you need to do. If the property is on the market, those three or four years of patient time don't exist.

VN: Right. You need to move now.

PS: That's when we come in. All the deals we've done, almost all the deals we've done, we’ve bought the property with all the rights intact … and then we've granted an option to a land trust ... to give them the right to buy an easement if they put the money together. And sometimes that happens in two years, sometimes in three years, four years, but it's usually that span of time.

VN: I'd like you to, if you could, just explain the business model.

PS: So the business model is, we like to make timberland investments. Timberland sellers perceive their value in their land as greater than its timber value. Break-up value, real estate development value, second-home development value.

So, we have a choice. We can buy the timberland and pursue some kind of real estate development and monetize that component of value and manage the rest as timberland. But that's kind of like two businesses. There's a timberland investment business and a rural real estate development business. The risk profiles of those businesses are completely different. One is sort of a steady income stream operating company, which is timberland. Then rural, or second-ome real estate development, is a remarkably cyclical business. So, 2005 it was a great business. Today, it's a …

VN: We're at the bottom of the cycle.

PS: So, if we're trying to demonstrate to our investors that we're good fiduciaries, good managers, that we can sort of predict the economic consequences of their investment, it's hard to do that in a cyclical, second-home, rural real estate sort of world. So the choice we’re making is to forgo the retail real estate opportunity and get, albeit at a discount, the wholesale value of the real estate out of the investment by selling a conservation easement. …

VN: How valuable are these easements?

PS: Anywhere from a third of the fair market value to two-thirds. So it can be quite considerable.

And that range has to do with the location of the property. If it's in absolutely the middle of nowhere, the future development value is going to be greatly reduced because it's going to be a long time before infrastructure or anybody wants to live there. If the recreational access is very, very significant, that's going to impede some of the timber harvest operation. So the easement is going to be a little more valuable because of that.

If the easement precludes, let's say wind siting because of scenic ridge values, then the easement is going to be a little more valuable or a little more expensive to buy. …

So a lot of our easements require stewardship activities, the management of the forests, to be above the letter of the law. So, an example of that is an easement that requires us to achieve third-party certification. This would be certification of such things as Sustainable Forestry Initiative and Forest Stewardship Council. These are like labels that we achieve through surprise audits of our harvesting operations.

VN: And the value in that certification is? …

PS: Two. One, we're like organic produce 25 years ago. It's not really getting a premium, to any great extent, for certified forest products, but it allows us to enter certain markets. To export to the European Union, you have to be certified. We have land in the Adirondacks, the low-grade products, the small trees, crooked trees, that come off that property go to a paper mill that makes an FSC branded office paper. So we actually do get a premium for delivering certified wood to that paper mill.

VN: Obviously, you believe that the easements and the conservation efforts have a bottom line argument to be made. But it also brings with it the complications of having to work with state agencies and nonprofits. Can you tell me about some of the tensions of working with some of those agencies that you ordinarily wouldn't have to work with if you were just doing straight timberland investment?

PS: The slightly simplistic metric we use is that our deals require at least 100 extra meetings. …

VN: I'd imagine a lot of those meetings are public information. So are you guys given any higher level of scrutiny?

PS: Yes, because public money is involved. … We bought Connecticut Lakes headwaters forest at the very top of the state of New Hampshire. That required public hearings by the Legislature, public meetings in the communities where the property resided.

People would ask about our management techniques, they would ask about our ability to provide for recreational access, issues between different kinds of recreational users, how do the cross country skiers interact with ATV people or snow machine people. So we get involved in management issues that most other timberland investors don't have to get involved in.

Some of the tensions are (because) some of the environmental organizations would like to see the property not have any timber harvesting whatsoever. So there's a balance between sort of a pure preservation approach that they might like verses what I would call conservation organizations who are more comfortable with multiple uses. …

VN: You're getting your revenue from various sources. How much of it comes from timber harvesting? …

PS: Our investments have sort of three types of income. So there's operating income, and that would be the timber harvest income or recreational lease income. Many of our properties, even though there's an easement, still have some amount of recreational leasing from hunting clubs, fishing clubs, stuff like that. Then there's what we call the episodic capital events, the sale of the conservation easement would be an example of that. So maybe in year three or year four in the life of an investment, we're getting 30, 40, 50 percent of our total capital back. And then there's the exit sale of the property.

I wish there was like a perfect formula, that it's always one-third operating income, one-third episodic capital events and one-third exit sales. But … probably the range is 25 to 40 percent over the life of the investment is the operating income. Depending on the year that the easement occurs and price point of the easement, another 25-40 percent is the easement. And the balance is selling the property for more than we had allocated as its basis as the exit sale. …

VN: A cynic would argue that easements are used as a bone to throw conservationists in order to get out of the way of development. We'll give you this land if you just let us put up our mini-mall. You guys aren't building mini-malls, but have you ever come across that argument? Has anyone ever accused you of that?

PS: Not really. I appreciate the argument and I think that there have been sort of development trade-off deals or mitigation deals where if you approve my big-box store on this farm, I'll conserve the farm across the road. Things like that. But the nature of what we're doing, 100 percent of what we're acquiring more or less is eased. So we're not reserving any special little place to stick (large developments). …

VN: You mentioned what you're doing wasn't so common 15 or 20 years ago when you joined Lyme Timber. What changed?

PS: I think three things changed. … Fifteen years ago was the beginning of the process of integrated forest products companies selling off their land base. You may be extremely well informed, but I would go talk to someone on the sidewalk and say, well Georgia Pacific, they must own timberland, they make tissue paper, cardboard. No, they don't own an acre. Louisiana Pacific doesn't own an acre of timberland. International Paper went from owning 6 million acres to less than 150,000 acres over that 15-year period.

So there were three reasons why that happened. One, was a really stupid accounting rule for publicly traded companies, which was the land stayed on their balance sheet at its basis. … We bought a lot of land from International Paper in the Adirondacks, their basis was $6 an acre. We paid them $500 an acre. The only way their shareholders could get that $494 of value was to sell the land.

Second thing that happened was that if you had a dollar of capital to invest as an integrated company, there was a much higher return investing in a paper mill or a fabrication plant … than buying timberland. …

Lastly, institutional investors discovered the asset class. So, 20 years ago, Harvard didn't invest in timberland. Dartmouth didn't invest in timberland. Yale didn’t invest in timberland. … So, starting over that 20-year period, the asset class was discovered, which was like this perfect storm. Sellers wanted to sell, financial owners who wanted to invest in the asset. Literally, 30 or almost 40 million acres of land transferred ownership during that 15-year period.

VN: Why was it attractive to institutional investors?

PS: Inflation hedge, a real asset. Then people started thinking bigger. Conservation biologists began to say, well, it's great that The Nature Conservancy found these unique plants at the bottom of this watershed and they can go buy 100 acres, but if they didn't care or protect or conserve the balance of the watershed, something could happen higher up in the watershed that could erode the value of the 100 acres that they bought. So, all of a sudden, … the scale of land conservation began to move parcel to parcel, watershed to watershed. …

Starting in the '80s, it's even true in the last election … there was $2.2 billion worth of voter approval of open-space finance measures in November of 2010. So that's town governments in the East, county governments in the West, state governments around the country. So you saw, all of a sudden, a very significant increase in the amount of public dollars that were available for conservation.

And lastly, there's one more item here. … In 2006-2007, net acres conserved (through) outright purchase, started to be exceeded by net acres acquired through conservation easements. So the tool of conservation easements became the more prevalent conservation strategy in the United States. … So those are all the drivers that caused us to continue to be doing this.

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