

OPINION

Political leadership needed to reform B.C.'s inefficient forest tenure



FOREST VIEW

PETER WOODBRIDGE

The tragedy of the current tenure system is that Crown forests in B.C. currently achieve one of the lowest levels of timber productivity in the western world

Speculative investors in B.C.'s forest sector are becoming increasingly excited about the prospects of a lumber "super-cycle." Their excitement is justified. The outlook for a windfall of super-profits within the next several years is supported by an unprecedented rising imbalance between timber demand and supply. Not just in B.C., but in many regions globally.

Let the good times roll!

Lumber consumers will be paying the tab. So why should British Columbians worry? After all, lumber is an underpriced commodity. On the heels of many tough years in the forest industry, isn't it only fair that our customers in Canada, the U.S., China and elsewhere should pay higher prices for this high quality, renewable resource?

The reality is that mill owners and long-term investors in the B.C. industry are not nearly so excited about the anticipated lumber super-cycle. They

welcome the short-term potential lift in earnings, but worry about the aftermath.

They have cause for concern.

Normally, at this point in the lumber demand recovery cycle, mill operators would be worrying about improvements in markets and prices. This time, it's different. They're threatened by a chronic timber supply crunch. Some of B.C.'s vital traditional lumber markets, notably the U.S., are still depressed. But this time, it's access to timber, not recovery in demand, that will hold back their businesses.

Although the worst is over, the pine beetle has destroyed at least 710 million cubic metres of pine timber in the B.C. Interior.

The number of dead pine trees is enough, in terms of structural lumber equivalent, to build all the single-family housing needs of the U.S. for the next 30 years – at current rates of housing starts.

Dead forests

The dead timber is a vital part of the log supply that would have helped sustain the Interior sawmilling industry over the next several decades. A significant volume is being salvaged, but an increasing number of dead trees are suitable only for bio-fuel production and pulp. The result is a 20- to 60-year "mid-term" shortfall before the remaining healthy commercial forests and seedlings being planted today are mature enough to harvest.

Concerns about the Interior region's mid-term timber shortfall are being voiced loudly to the B.C. government's **Special Committee on Timber Supply** (SCTS) currently touring Interior communities. The joint-party committee has been given wide scope – but not much time – to evaluate the crisis and recommend ways to bridge the mid-term timber shortage.

One message being sent loud and clear to the committee is "don't compromise on long-term sustainability." It's not just timber-dependent communities and environmentalists sounding the alarm. Professional groups, such as the **Association of BC Professional Foresters**, have warned government and the committee not to borrow from tomorrow's healthy forests to bridge some of the shortfall.

At stake are thousands of jobs and the economic and social livelihoods of numerous timber-dependent communities.

One good thing arising from the pine beetle tragedy is this: there's an emerging recognition that it's time for structural changes in B.C.'s timber supply model. In other words, bold tenure reform.

Part of the problem is that the B.C. government keeps saying "no" to any discussion of the types of innovative tenure reforms that would attract the massive investment needed to upgrade the Crown working forest beyond basic forestry. Heck,

successive ministers won't even talk about it.

The committee is being steered in the same direction by senior government advisers. They are presenting options to the committee that reinforce the status quo. It's their own system they're defending. In the view of many outside experts, the current system is broken and is in no condition to handle a crisis of the magnitude and complexity of the pine beetle epidemic.

At the heart of the B.C. Interior timber supply problem and mills' wood costs: Crown timber growing on the stump is not allocated by a competitive market mechanism but ultimately by a cadre of senior mandarins in Victoria. This powerful group also determines the ceiling for harvest levels. Licensees of Crown timber (i.e., the mills' owners) are permitted to decide how much timber to harvest – but only up to the maximum annual harvest volume allowed by government.

Ineffective allocation

It is an administrative allocation of public timber – and an effective cap on harvesting levels – based on science, experience and judgment. But it is far from being infallible, and it's a system that many people increasingly believe is ineffective and several decades past its "best by" date.

Economic historians will treat the system with respect. For over 100 years, it served the

province well.

But that's history.

Investors, especially long-term investors – concerned about today and tomorrow, and the potential rate of return on very scarce and risk-averse global capital resources – have to be much more critical.

If past performance is prelude, the outlook is not good for existing longer term investors in B.C.'s forest sector. It doesn't have to be that way. Yet the forest industry is confined to the status quo on Crown timberlands by the government-managed system.

The shockingly low past performance record of the B.C. forest industry simply will not retain and attract the magnitude of capital and operating investment required to address the B.C. Interior timber shortage and other structural investments needed. The industry achieved only a 4% average rate of return on capital over the last 20 years – much lower than its average cost of capital.

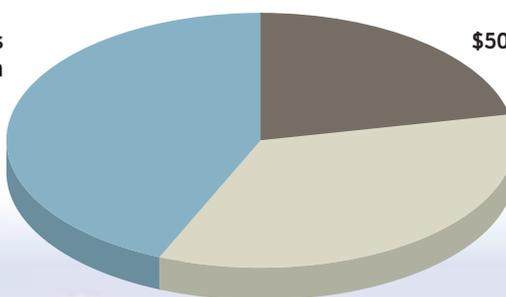
There is a future scenario of B.C.'s forest products mix that envisages a shift to alternative technologies – an expansion of the current wave of bio-energy investments (essentially burning wood to produce electricity) and a future that includes capacity growth in bio-refined products (such as carbon fibres). They are great products.

However, for the economics to work, demand requires high fuel prices and, in many cases, price subsidies.

These are good developments for B.C. and the forest sector. But they draw attention away from the lack of profitability of many of B.C.'s traditional forest products. They divert discussion of how to solve the dual crises of

Government funding to help B.C. Interior communities to manage and recover from pine beetle infestation

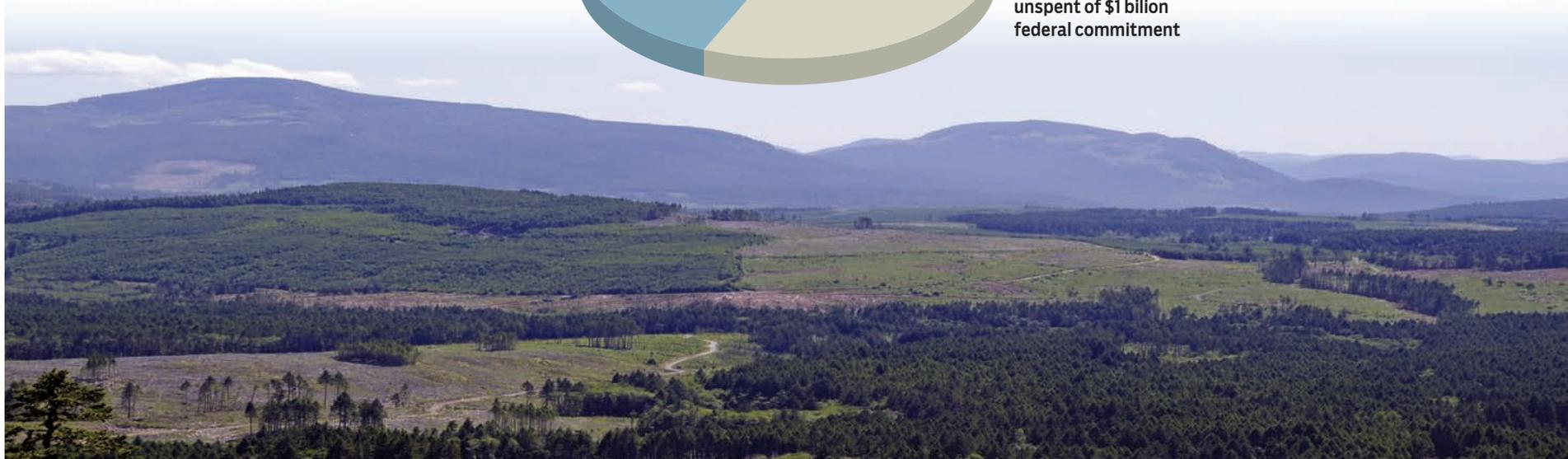
\$1 billion impacts and mitigation



\$500 million forest productivity

\$800 million unspent of \$1 billion federal commitment

CONTINUED ON PAGE 38



FORESTRY | Lost in the woods

4% average rate of return on capital in forest industry over the last 20 years

\$2.3 billion taxpayer funds allocated to B.C.'s pine beetle crisis since 2001

\$4 billion investment needed to improve yield on top Crown forest land

710 million cubic metres amount of pine timber destroyed by pine beetle in B.C.'s Interior

POLITICAL LEADERSHIP

CONTINUED FROM PAGE 37

providing adequate timber supply and rising wood costs.

These issues speak to the core of the global competitiveness of B.C.'s traditional product mix of lumber and wood products and pulp. Shifting to a tenure system focused on intensive Crown land productivity (rather than extensive use) offers the best prospect for lowering wood costs for sawmills and other users of wood fibre. B.C.'s current tenure system, and its dated approach to allocating Crown timber, shortchange the wood products industry and pulp and paper sector. These systems are preventing the industry from striving for, and potentially achieving, a substantial and sustainable improvement in its global cost competitiveness.

In Victoria, there seems to be a mindset that attrition and decline of traditional forest products is inevitable – and OK. That's woefully wrong.

Most of the \$1.5 billion spent to date has been aimed at dealing with impacts. There's nothing wrong with that. But only about

one-third of the money spent has gone back into improving the land base and growing forests for tomorrow.

At the heart of the solution to the timber supply crisis is B.C. forest-land productivity. It's also the best route to achieving sustainably lower wood costs per cubic metre harvested.

The forest industry often becomes preoccupied with timber and forgets that, ultimately, it's the land – not the comparatively short-term timber crop – that is the key. Forestland productivity leads to higher timber yields, value-added manufacturing, improved sustainability and habitat protection as well as the ability to provide for other forest values.

Low wood costs are critical to long-term sustained investment in all types of products – whether they are traditional or value-added or new technology bio-products. Global competitiveness is based on cost competitiveness, and, in B.C., the key to that is the productivity of the forested land base.

Expert evidence presented to the committee indicates that intensive silviculture – which is

just one of the routes to managing the Crown working forest better – would involve spending of at least \$2,000 per hectare.

Investment incentives

Assume, for the moment, that this investment is applied only to the best and highest yielding 10% of the Crown's timber growing sites. That's an investment of roughly \$4 billion – which the B.C. government is unlikely to be willing, or able, to fund. In fact, the total investment dollars needed for forest management levels above basic forestry are much higher.

Long-term investors, and professional timberland managers, have shown an interest in making such types of investments. That's patient, long-term money – the kind needed for long rotation crops such as timber.

The tragedy of the current tenure system is that Crown forests in B.C. currently achieve one of the lowest levels of timber productivity in the western world.

It's in the management.

Instead of limping from cycle to cycle, B.C. mill owners and long-term investors should be investing continuously in the

province's potential to grow areas of "super forests." That will require tenure reform.

Forget privatization of public timberlands. It won't wash with British Columbians. B.C.'s Crown forest land is not for sale – quite apart from the fact that numerous land claims have yet to be resolved.

But privatization of the timber crop itself – on a leased management basis – is quite another thing. The land remains in public ownership. Licensees have the financial incentive to invest heavily because they know that they can harvest and sell the improved crop at maturity, or on shorter rotations. They have to comply with all environmental regulations – or face stiff fines. Importantly, they have stronger motivation than under the present system to invest in productivity and perhaps value-added manufacturing.

There are many others reasons why the existing tenure system and the Victoria-based Crown timber allocation system won't work in renewing B.C.'s Interior forests. For example, bureaucrats shouldn't be in the business of growing trees. Nor

should they be driving the bus for those in the private sector, such as timberland investment managers (TIMOs) and others, who have a proven track record elsewhere of being successful timberland operators and tree growers.

The SCTS has been given a short four months to complete its evaluation and deliver its final report by August 15 to Victoria. If it's sustainable timber supply it's after, not just a politically expedient band-aid solution, tenure reform should be part of the committee's recommendations. Whether there's an appetite for it in Victoria depends on how much leadership either this government, or the next, is willing to show.

Either way, short-term investors in lumber stocks can look forward to a feast of good earnings they will not have seen in B.C. since the last boom in 2004. Longer term investors may want to keep their powder dry. ■

Peter Woodbridge (www.woodbridgeassociates.com) is president of Woodbridge Associates Inc. His column appears quarterly in *Business in Vancouver*.

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