# Complementary Solutions to Liquidation Harvesting:

## A Report to the 121st Maine Legislature Second Regular Session

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# Executive Summary

Liquidation harvesting has been defined by the legislature as the practice of purchasing timberland, harvesting timber to remove most or all the value without regard for long-term forest management principles, and re-selling the land within a five-year period. The 121st Legislature further determined that the practice of liquidation harvesting was having negative impacts to Maine's forest resources, and directed Maine Forest Service and the Commissioner of the Department of Conservation to:

- Conduct a field study of recent harvest sites that may meet the definition of liquidation;
- Develop rules to "substantially eliminate" the practice of liquidation harvesting;
- Report to the legislature on what it called "complementary solutions" to the issue of liquidation harvesting which go beyond the liquidations harvesting rules themselves.

This document addresses the last of these directives, and truly does complement the rules developed as part of the effort to "substantially eliminate" liquidation harvesting. In charging the Commissioner to report back to the legislature on the issue of complementary solutions, the legislature recognized that liquidation harvesting is not a simple issue, and that no one action is likely to be effective in "substantially eliminating" the practice. Rather, a number of incentives and disincentives will be needed to get the job done. This report is a compilation of the ideas, drawn from discussions with Stakeholders, which could productively be employed to end liquidation harvesting. However, neither the rules themselves, nor these "complementary solutions", can stand alone. Instead, these two efforts form an integrated whole and must be considered together and in the context of ongoing work of the Department.

A Stakeholder Group was assembled in August 2003 to assist MFS and DOC in developing solutions to address liquidation harvesting. The Group discussed the issues thoroughly and MFS distilled several key principles from these discussions:

- **There is no silver bullet.**
- **Multiple strategies are needed.**
- **Rules addressing liquidation are central.**
- **Both incentives and disincentives are needed.**
- **Unsustainable practices will persist if they remain profitable.**

The Group explored a long list of possible solutions. Several proposed solutions are predicated on the establishment of liquidation harvesting rules. Several other solutions remain in conceptual form and will require additional exploration before they can be implemented. The proposals were discussed in depth by the Group, but the final report and implementation plan was compiled by the Department of Conservation's Maine Forest Service and recommended to the Commissioner of Conservation after the Group's last meeting. While the MFS and the DOC owe a debt of gratitude to the

Stakeholders who committed long hours to exploring these ideas, this report should not be read to imply that the Stakeholders, individually or collectively, agree with all the ideas contained here. Some members may agree with all of the proposals articulated here, while others favor some, but not all proposed solutions.

The Department recommends implementation of a range of measures, including:

- Ongoing departmental efforts and related initiatives
- Recommendations, as outlined here, to focus on near-term solutions in the 121st Legislature's Second Regular Session
- Establishing processes to explore further additional measures in 2004.

**Ongoing Departmental Efforts**: The context for these recommendations includes continued Maine Forest Service monitoring of liquidation harvesting, and efforts to improve enforcement of existing laws including modifying fine structures, as well as initiatives to address professional accountability, forest certification, and education. The liquidation harvesting rules will have bearing on several of these efforts and the recommendations in this report.

**Legislative Action to Implement Near-Term Solutions:** Recommendations to in the 121st Legislature's Second Regular Session are to:

- seek additional attention to mill procurement policies that encourage sustainable management and discourage liquidation harvesting, through private sector initiatives; and
- enact legislation to prevent subdivision of liquidated land.

**Legislative Support for Additional Working Groups:** Exploring these ideas further for possible implementation involves establishing working groups that will specifically address:

- incentives for sustainable forest management;
- incentives to encourage new timberland investment for sustainable forest management; and
- tax policies to support long-term ownership.

The resources needed to conduct these efforts remain to be identified. Some ongoing and targeted efforts can be made with existing resources. However, the Department's ability to develop further new measures will be limited without additional support. Costs to the state and economic impacts of implementation of individual proposals similarly will need to be examined by the individual working groups.

## Section I: Introduction/Background

As defined by the legislature, liquidation harvesting is a short term practice involving timber harvesting and real estate transfer without attention to the principles of long term forest management. Liquidation harvesting can have negative impacts on timber productivity and forest stand quality, and can degrade soil productivity, wildlife habitat, water quality, and aesthetic/recreational values. Further, it can contribute to breaking larger parcels of forest land into smaller parcels which can be more difficult and expensive to manage, and where landowners generally place less emphasis on managing for timber than other values. Thus, liquidation can compromise future management opportunities and the communities that depend on forest resources.

Discussions regarding liquidation harvesting have occurred over the last decade and a half, beginning in the late 1980s with the breakup of a few key timberland ownerships. However, the practice itself is considerably older, and harkens back to the process of purchasing of property, heavy timber harvesting, and allowing land to revert to the town for unpaid property taxes. With higher land values, today the practice involves resale of the land, rather than allowing the land to revert to the town.

In the mid 1990s, the Northern Forest Lands Council identified, among other issues, concern with certain timber harvesting practices including harvesting without regard for long-term forest management principles, often in conjunction with land sales. Liquidation harvesting specifically emerged as a policy issue during ensuing debates over clearcutting and heavy harvesting.

During every legislative session since the mid 1990s, legislation has been proposed to deal with these issues. Most, but not all such efforts have failed. Legislation has been proposed to address the issue by a number of means, including further regulating forest practices, modifying the Tree Growth Tax Law, imposing penalties on short-term land and timber gains, and eliminating loopholes in land use laws.

Legislation approved in the last 5 years addressed several specific concerns with forest practices related to liquidation harvesting. Amendments in 1999 to the Forest Practices Act required increased planning, and justifications for clearcutting. Repeal of the 40 acre exemption in 2001 and 2002 closed subdivision loopholes in both organized and unorganized townships. Changes to the Tree Growth Tax Law in 2002 clarified the program's requirements and created mechanisms for increased oversight by towns.

Studies conducted by Maine Forest Service in 1995, 1999, and 2001 contributed data to help quantify the impact of liquidation harvesting in Maine. While results of these studies gave a wide range between their estimates of affected acreage, each suggested that liquidation harvesting was sufficiently widespread to have a continuing negative impact on Maine forests.

By 2001 the Maine Forest Service, in its biennial State of the Forest report, had specifically identified liquidation harvesting as a forest practice that was damaging

Maine's forest resources.

Concerns with liquidation harvesting include, but are not limited to its effects on the productivity and value of the future forest. In this and other regards, liquidation harvesting can:

- Prematurely remove trees in size classes (poletimber and small sawtimber) that are growing merchantable wood volume most rapidly, thereby reducing current and future productivity of the site;
- Prematurely remove trees that have the potential to increase in value class (e.g. from pulpwood to sawtimber class), thereby reducing the potential future value of the stand.
- Remove better quality trees and leave poorer quality trees with little potential to increase in value;
- Leave understocked stands that accumulate wood slowly relative to pole and sawtimber stands with desirable stocking levels;
- Delay future harvesting opportunities for several decades;
- Shift current and future composition of regenerated stands toward less desirable species, and reduce the proportion of some of the most valuable species for the future;
- Eliminate seed sources of some desirable tree species;
- Reduce the viability of future forest management and thereby encourage non-management or conversion to other land uses;
- Damage soil, water, wildlife, recreation, or other values;
- Break larger tracts into smaller parcels -- management of the resulting smaller tracts is more costly per unit of wood volume produced. Further, the non-timber objectives of new owners (typical of the owners of small tracts), or subsequent development result in some land leaving the working forest base entirely; and
- Result in violation of Maine's environmental laws, in general. Liquidation harvests are often associated with violations of forestry or other environmental laws.

Finally, the public perception of forest management can be damaged by activity on lots which are heavily harvested without regard for the principles of long-term forest management. Unfortunately, such examples tend to draw attention from and overshadow the conscientious work of innumerable landowners, loggers, and foresters to sustain the forest of the future.

In addition, persons interested in sustainable long term forest management find it difficult to compete with liquidators in buying forest land, due to the liquidators' profit in the short term from both the removal of wood and the re-sale of the land. This discourages investments in long-term forest management.

In 2002 the legislature passed PL 2001, c. 603, "An Act to Address Liquidation Harvesting" which made several changes in requirements of the Forest Operations Notification and in the Tree Growth Tax Program. The law also provided a definition of liquidation harvesting and directed MFS to continue studying the issue in a quantifiable way. It reads as follows:

> "For purposes of this section, "liquidation harvesting" means the purchase of timberland followed by a harvest that removes most or all commercial value in standing timber *without regard for long-term forest management principles* *(emphasis added)* and the subsequent sale or attempted resale of the harvested land within 5 years. As more information is gathered on this practice, the Director of the Bureau of Forestry shall advise the joint standing committee of the Legislature having jurisdiction over forestry matters on recommended revisions to this definition to better describe and quantify practices that threaten timber supply and warrant policy consideration."

In 2003 the legislature enacted PL 2003, c. 422, "An Act to Promote Stewardship of Forest Resources", which codified the above definition in statute. The law also directed the Commissioner of Conservation to both adopt new "rules to substantially eliminate liquidation harvesting", and to report on additional "recommendations and an implementation plan for solutions to the issue of liquidation harvesting" (so-called complementary solutions).

In the context of rulemaking, the legislation specifically called for measures that would:

- Increase professional involvement in timber harvest planning and implementation;
- Require that timber harvesting activities be conducted with attention to long-term forest management principles;
- Exempt landowners and land managers with independent third-party certification, small acreages, and permitted conversions.

The legislature also required that the report on additional or "complementary" solutions to the issue of liquidation harvesting include:

- "Improvements to standards and guidelines for timber harvesting;
- Increased professional involvement in timber harvesting;
- Improved professional accountability of foresters;
- Modifications to land use laws;
- Disincentives to liquidation harvesting;
- Incentives for landowners who receive independent, third-party certification that their forest lands are well managed;
- Economic policies to expand markets for forest products harvested from well-managed forests, and to promote Maine as a world leader in green-certified forest lands, as certified by the Forest Stewardship Council, and forest

products;

- Other relevant approaches".

In response to these mandates, Maine Forest Service undertook three initiatives. First, it began a field evaluation of liquidation harvesting. Beginning in July 2003, a technical advisory team was assembled, field sampling protocols were developed, and an extensive review and assessment of recent harvests was conducted. The study collected information on harvests from 2000-2001 where the parcel involved had been purchased, timber was harvested, and the property was subsequently sold within five years of the date of the original purchase. Results of this evaluation are being reduced to writing and included in a report. Second, a Stakeholder Group was established to advise the Maine Forest Service on the rules called for in PL 2001, c. 603 to "substantially eliminate liquidation harvesting." This "Rulemaking Committee" has been working with the Maine Forest Service to see if the Stakeholders can reach agreement on a set of rules, or at least narrow the areas of disagreement. Finally, a second Stakeholder Group was assembled to discuss other "complementary solutions" to the issue. This latter Group's discussions in large measure provided the basis for this report.

## Section II: Development of Complementary Solutions

The Department has devoted considerable resources to the liquidation harvesting issue, including the development of this report. To assist the Department in brainstorming and developing specific ideas, the Maine Forest Service established the Liquidation Harvesting Complementary Solutions Committee in the summer of 2003. The Group first convened on August 7. Members were selected to include representatives from forest industry, professional loggers, state agencies, municipalities, industrial and non-industrial landowners, environmental groups, financial institutions, legislators, and the general public. Complementary Solution Committee members included:

Gary Bahlkow, forester, LandVest
Sandy Brawders, director, Professional Logging Contractors of Maine
Harold Burnett, consulting forester, Two Trees Forestry
Jenn Burns, staff attorney, Maine Audubon
Catherine Carroll, director, Land Use Regulation Commission
Diano Circo, Natural Resources Council of Maine
Rick Givens, Maine Sporting Camp Association
Jay Haynes, logging contractor and landowner, HC Haynes
Representative Ted Koffman
Kevin Mattson, principal, Harpers Development
Hank McPherson, logging contractor and landowner, McPherson Timberlands
Mark Miller, consulting forester, Conservation Forestry
Fred Morton, timberland banker, Farm Credit Maine
Bill Ostrofsky, chairman, Professional Forester Licensing Board
Jim Runyan, procurement forester, Georgia-Pacific
Peter Triandafillou, chief forester, Huber Resources

At the first meeting, Committee members were provided with background information on the liquidation issue, a briefing on collaborative processes, and other instructions. Maine Forest Service Director Alec Giffen facilitated meetings, with assistance from MFS staff forester Morten Moesswilde. The Committee members were encouraged to engage in creative problem-solving and an open exchange of. Meetings were frequently chaired by Committee member Representative Ted Koffman. In November, Committee member Mark Miller was contracted to assist MFS staff with research and report writing.

The Committee met six times between August and December 2003. A summary of meeting dates and topics follows. The full agenda and handouts discussed at each meeting are found in the separate appendix volume. Meeting notes in the form of flip charts were kept at each meeting to capture the essence of the discussion, but were not reproduced for this report. In addition, members devoted considerable time outside meetings researching solutions, providing analyses, and drafting text.

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| August 7 | introduction, ground rules, brainstorm possible solutions |
| September 11 | discuss pros/cons of possible solutions and begin prioritizing |
| September 30 | field trip to liquidation field study sites (with Rulemaking Committee) |
| October 6 | receive additional background, new ideas, and further refine solutions |
| November 6 | rate practicality and effectiveness of proposed solutions |
| December 4 | review draft recommendations |

The Committee began its work by brainstorming to develop a comprehensive list of all potential solutions. The solutions considered were wide ranging. The Group narrowed the list by eliminating solutions judged to be unrealistic, operationally impractical, or ineffective. Over several meetings the solutions seen as viable were further debated, discussed, and refined. The Committee did its best to determine the benefits, adverse impacts, feasibility, and costs of each solution. The final set of solutions were those that received the most attention, and were rated by a substantial proportion of the Committee members as being widely applicable, relatively feasible to implement, and likely to contribute effectively to the reduction of liquidation harvesting.

Despite efforts to focus on a small number of proposals, the Committee ultimately identified a considerable array of proposals that they believe may have merit. In addition, although the Group worked to achieve consensus, several of the proposals included in this report remain contentious. A near-final draft of this report was reviewed and commented on by members via e-mail. The Department thanks the Committee members for their contributions and giving generously of their time, and accepts responsibility for the content of this report in light of the fact that the Stakeholders Group was not able to reach consensus on all the issues involved.

### *The Context for these Recommendations*

Ongoing efforts of the Maine Forest Service and concurrent initiatives, including the development of rules to substantially eliminate liquidation harvesting, were the subject of considerable discussion by the Complementary Solutions Committee. Such efforts provide important context for understanding how the recommendations in this report have been prepared, and how the Department proposes to move forward in addressing complementary solutions to liquidation harvesting. These efforts include:

- Liquidation Harvesting Rules: This effort to "substantially eliminate" liquidation harvesting has played a key role in determining how complementary solutions are structured. For example, the Department believes that a capital gains tax penalty as discussed by the Group is not justified at present, because the Maine Forest Service can, through enhanced enforcement action, eliminate the financial gain from liquidation harvesting. However, the liquidation harvesting rules are based on the existing legislatively enacted definition of liquidation harvesting, i.e. buying land, harvesting, and selling. If over time other practices develop that also involve rapid turnover of ownership and harvesting without regard to long-term forest management principles, but that fall outside the existing definition of liquidation harvesting (e.g. cut, buy, sell, or buy, sell, cut sequences), a capital gains tax approach may be an appropriate mechanism to address such practices without modifying the liquidation definition.

- Education: Though education is further discussed below, it is important to note that it already constitutes a focus for the efforts of the Maine Forest Service as well as other entities. Education is an important component of several of the recommendations included in this report. Implementation of these ideas will require balancing any new efforts with existing outreach to landowners, loggers, foresters, and others.

- Monitoring: Maine Forest Service conducts ongoing field assessment of timber harvesting activity, and as directed by the legislature, will continue to monitor the level of liquidation harvesting specifically. In addition to collecting data on liquidation harvesting, MFS collects data and reports on other statewide timber harvesting activities. These evaluations will inform future efforts to educate and enforce timber harvesting rules, and allow MFS to monitor progress in achieving the goals and objectives set by the legislature, as well as to modify its programs as needed to maximize their effectiveness.

- Professional accountability: The responsibilities of Licensed Foresters for harvests on lots which are bought, cut and sold within five years, are being addressed in the liquidation harvesting rules. Issues of forester accountability and licensure were discussed by the Complementary Solutions Committee and acknowledged to be important in the effort to "substantially eliminate" liquidation harvesting, as well as to encourage sustainable management. The Department of Conservation will work closely with the Board of Licensure for Foresters and the Office of Licensing and Registration, to ensure that foresters are aware of liquidation and other rules, available training, and the consequences of noncompliance. The Governor has indicated that he will call for a review of how the role of the Board of Licensure could be enhanced, particularly in light of the increased responsibility placed in the hands of professional foresters through the rules on liquidation harvesting.

- Enforcement of existing laws: Maine Forest Service is currently conducting an internal assessment to enhance its ability to enforce current laws, including Forest Practices Act violations, timber trespass, and timber theft. We anticipate renewed efforts to educate and work with District Attorneys, improve investigative efficiency, and assure appropriate penalty structures. We expect that these efforts will have a positive impact on ongoing enforcement, and increase deterrents to violating the law. In particular, Maine Forest Service is evaluating whether changes in statute may be needed to modify allowable fines for forestry violations.

- Certification: The Forest Certification Advisory Committee is addressing policies to expand markets for and sustainable management of certified timberlands. Some of the recommendations in this report which encourage sustainable management will likely complement the certification effort.

The Department intends to address the issue of complementary solutions for liquidation harvesting in the context of these broader efforts.

## Section III. Key Recommendations

The following recommendations are presented as an interrelated package of proposals and recommendations, based in large part (but not solely) on the Committee's discussions, and further developed by the Department of Conservation's Maine Forest Service. Together the recommended solutions attempt to mitigate a variety of conditions that favor the practice of liquidation harvesting, and other recommendations are aimed at encouraging sustainable management and long-term ownership of forestland. These complementary solutions are not sufficient by themselves to halt the practice of liquidation harvesting. Instead they are part of a coherent strategy that involves the rules, incentives, and disincentives beyond the rules themselves; as a package this combination will work to eliminate the practice – individually they can not.

Several key principles emerged from discussions on this topic:

- **There is no silver bullet.** Forest practices have evolved over time in response to a wide array of factors, and no single proposal on its own can completely, or even substantially, eliminate a particular practice like liquidation harvesting.
- **Multiple strategies are needed**. In recognition of the complexity of the forest industry, land ownership patterns, and public values, an array of solutions implemented over time will be necessary to substantially eliminate liquidation harvesting. Individual solutions implemented in isolation will either be ineffective or have a much reduced impact.
- **Rules addressing liquidation are central**. As it was not the charge of the Committee to participate directly in the effort to develop rules, we focused on solutions that were outside the rules for liquidation harvesting itself. At the same time we recognize that that effort is essential to substantially eliminating the practice of liquidation. Some of the proposals included here depend on effective rules in order to have any "complementary" impact.
- **Both incentives and disincentives are needed**. While rules addressing the practice are the greatest immediate "disincentive" to the practice of liquidation harvesting, "complementary" solutions may be most effective as long-term solutions if both incentives to sustainable management and disincentives to liquidation are included, in a balanced approach.
- **Practices will persist if they remain profitable.** Liquidation will continue if economic incentives to engage in the practice remain, especially ones that greatly exceed economic returns from sustainable management. Measures aimed at substantially eliminating liquidation must include penalties that outweigh the anticipated financial gain from the practice, rather than becoming a "cost of doing business".

This said, recommended actions need to be targeted, feasible, and integrated with other measures. The essence of the recommendations is summarized briefly here, and is explained later in more detail.

Some of the proposed solutions have broad application and cut across several issues; some are incentives to sustainable management; still others are primarily disincentives to unsustainable management. **Incentives** have as their goal encouraging (or removing barriers to) investment and sustainable forest management. They seek to reward landowners for retaining and managing land for the long term as working forest. **Disincentives** are intended to result in financial consequences for activities that run counter to long-term forest management principles. The attraction and success of the liquidation harvest model is based on the expectation that profits can be maximized under this model. Reducing profits from liquidation harvesting provides a direct disincentive for this business practice, and we expect will benefit the long-term future of Maine's forest products industry, economy, and workers by increasing the quantity and quality of wood produced. Considerable concern was voiced, however, about potential negative effects of disincentives. The disincentives described here are aimed at discouraging the practice of liquidation harvesting and are those that received the most discussion. They were not supported by all the Committee members, but were passionately supported by some.

### *Crosscutting Solutions*

- Mill procurement policies – Encourage mills to establish mill procurement policies that encourage the purchase of timber from sustainable sources, and discourage wood purchase from liquidated land; and
- Education – Initiate a concerted effort to increase awareness of the negative impacts of liquidation harvesting, and of opportunities for sustainable management, among the forestry community, landowners, and the general public.

### *Incentives*

- Loan guarantees – Offer state-guaranteed loans for the purchase of timberland, provided that the loan recipient makes a commitment to sustainable forest management;
- Incentives to consolidate – Reduce real estate transfer fees and other incentives for landowners who consolidate parcels for timber management by acquiring abutting forestland, and commit to sustainable forest management;
- Reduced taxes on capital gains – Reduce state capital gains tax on sales of forestland held for long term management (10-20 years or more);
- Timberland investment using retirement funds – Establish a mechanism to encourage investment of Individual Retirement Accounts and similar funds in sustainably managed timberland properties;
- Sustainable Forestry Revolving Loan Fund – Establish a means of funding landowner forest management plans and certification costs for landowners, to be paid back from timber harvest proceeds;
- Property tax rebates – Monitor, to determine its potential applicability to Maine,

an established program in Minnesota that provides property tax rebates for landowners who commit to long-term sustainable forest management; and

- Reduced estate taxes – Explore mechanisms to mitigate estate taxes where they impede continuation of sustainable management.

**Disincentives**

- Evaluate the need for capital gains penalty – Defer action on any proposals to impose capital gains tax penalties on liquidation harvesting. The Department believes that other measures proposed herein, along with active enforcement by the Maine Forest Service, as described in the section on context, should substantially eliminate liquidation harvesting. Evaluate, once liquidation harvest rules and enforcement are in place, the effectiveness of the measures adopted and the need for any additional measures to assure that penalties for illegal liquidation harvesting are commensurate with economic gains; and
- Subdivision of liquidated lots – Prohibit subdivision of parcels that are found to have violated liquidation harvesting rules.

This package of solutions is designed to be consistent with, and to supplement the liquidation rulemaking effort. They are interdependent and both are necessary to substantially eliminate liquidation harvesting.

### *Summary of Stakeholder Consensus/Disagreement*

The Stakeholder Group had the greatest degree of consensus around the education proposal. There was considerable agreement that education plays an important role, though some expressed the view that by itself education might have little impact. There was also considerable agreement that ongoing enforcement of forestry laws was important.

Most incentives had some degree of support from most members of the Group, though there was some degree of disagreement about how effective incentives would be, and what requirements of individual programs would be necessary to ensure that only sustainable forest management was being supported. A number of committee members expressed the view that incentives alone would be sufficient to substantially eliminate liquidation harvesting.

Within the Group there were widely ranging views on the potential and possible means by which procurement polices could help address the liquidation harvesting. While some view it as a market-based solution with high potential to effect changes in behavior, others suggested that, while important, procurement policies have less value for addressing public policy issues such as liquidation in the context of a competitive industry. For procurement policies to have maximum effect they would have to be coordinated across the industry. This may present difficulties as a voluntary measure in terms of coordinating the many parties involved and avoiding problems with anti-trust issues.

Proposals for disincentives resulted in the greatest disagreement among stakeholders. While the subdivision penalty prompted concern primarily about off-target impacts, the capital gains tax proposal was sharply opposed by some, and equally strongly supported by other members. Some expressed the view that rules to substantially eliminate liquidation harvesting by themselves constituted adequate disincentives to the practice. Others argued that a capital gains measure was essential to assure that financial incentives to the practice of liquidation were removed.

The Department thanks the Stakeholders for their efforts, but also accepts final responsibility for the contents of this report.

### *Mill Procurement Policies*

**<u>Solution</u>: Encourage sustainable forest management practices on harvested properties through mill wood procurement policies, reducing markets for liquidated wood and supporting sustainable management.**

**<u>Concept</u>:** Encourage mills to offer preferential supply agreements for wood produced by "sustainable suppliers", including, but not limited to, landowners and harvest operations that do not engage in liquidation harvesting, as well as wood coming from third-party certified sources, and to discourage the purchase of wood from liquidation harvests.

**<u>Implementation</u>:** Implementing this solution requires voluntary action by wood purchasing mills to adopt appropriate, effective procurement policies, and devote resources to assure that such policies are adhered to. Greatest positive impact would result from adoption of similar procurement policies by most if not all mills. Primary mill commitments would be to:

- **Offer preferential supply agreements to sustainable wood sources, especially certified ownerships and loggers**
- **Establish procurement policies that discourage the purchase of wood from liquidated lands.**

This recommendation builds on the "Joint Resolution Supporting Well-managed Forests and Sound Forest Products Procurement Systems" passed in the 2003 session of the Maine Legislature, which called on the Maine Forest Products Industry to adopt such policies. The recommendation here is to review the response to this resolution from the Forest Products Industry and to determine what else, if anything, is necessary to encourage such policies and their effective implementation.

**<u>Discussion</u>:** Mill policies can have a significant influence on the quality of timber harvesting and the condition of Maine's forests. Most large mills in Maine participate in the Sustainable Forestry Initiative (SFI), which requires companies to support the principles of sustainable forestry in their procurement policies, and to foster the improvement in professionalism of wood producers. The 2003 Legislative Joint Resolution calls on the state's forest products industry to encourage policies to reduce purchases of liquidated wood, and to obtain wood only from suppliers who conduct responsible harvests. This proposal does not contemplate that mills would be required to determine at the time of delivery whether or not the wood involved was from a liquidation harvest; rather that suppliers would be put on notice that the company did not want to purchase wood from such harvests, and that, if after the fact, it was determined that such wood was being knowingly supplied, there would be consequences.

Many mills monitor harvest practices on the properties from which they purchase wood, both during and after harvest. Mill procurement policies stress adherence to harvest-related outcomes such as use of BMPs, damage to residual trees, utilization of harvested wood, and regeneration. Mill policies generally have not addressed issues such as liquidation harvesting, or other post-harvesting issues such as BMP maintenance. However, a few mills reportedly have dissolved contracts with loggers whose harvests have violated environmental laws repeatedly, and at least one papermakers has publicly stated a preference for wood coming from "certified" suppliers.

Maine Forest Service, as the enforcement authority for timber harvesting laws, will be responsible for determining what constitutes a violation of liquidation rules. If mills were to discriminate against persons or firms that participate in liquidation harvesting, as determined by MFS, there would be a strong disincentive to the practice.

Beyond discouraging the purchase of wood from liquidation harvests, mills could implement a procurement policy giving preference or perhaps a price differential to sustainable suppliers. Recognizing independent third-party certification systems offer one possible mechanism for such a policy, and an increasing number of ownerships are under some form of certification, and hence, sustainable management. In addition, certified loggers who adhere to standards including non-participation in liquidation harvesting could receive preferential consideration under purchasing policies. The Master Logger Certification (MLC) program is a voluntary, third-party verified audit and assessment process that recognizes excellence in sustainable logging practices, and seeks to strengthen a "land ethic". Currently 47 companies in Maine are MLC certified, representing 50 percent of Maine's wood producing capacity. Another 41 companies are in the process of certification, with 57 firms on a waiting list awaiting funding possibilities. Some mills already provide one or more of these incentives but the practice could be broadened.

**Benefits:** Effective procurement policies that significantly curtail markets for liquidated wood would be among the strongest market-based disincentives to the practice. Preferred supplier agreements could encourage sustainable forest management, and help bring about an increase in certified acreage, greater professional involvement in timber harvests, and increased involvement in the MLC program. The high professional standards and ongoing audit function of the MLC program ensure a higher regard for future forest productivity, and could empower loggers to turn down work for landowners who wish to liquidate — thus reducing the incidence of liquidation harvesting.

**Adverse impacts:** If procurement policies are inconsistently applied, liquidated wood will find other markets. Also, in tight wood supply situations, procurement policies could have limited impact because simply keeping the mills operating would be the major concern. Mills could lose incentives to implement procurement policies if such policies place mills at a competitive disadvantage in purchasing raw wood without corresponding benefits. To the extent that such an approach results in more land being certified, it is important to recognize that certification systems are an additional financial burden on landowners and/or logging firms. Financial support for certification from public sources is limited; redirecting existing sources would detract from other efforts to encourage sustainable forestry.

**Feasibility:** SFI objectives and performance measures already require program participants to use procurement policies to ensure sustainable harvesting practices, but they have not been extended to cover liquidation harvesting. In many cases, mills could strengthen existing programs and policies.

**Cost:** Wood procurement policies would have no cost impact to the State, but would have costs to the industry. The costs to individual mills, or the industry as a whole, are not available to the Maine Forest Service for use in this report, but might be minimized by emphasizing preferential supply agreements (over premiums). Costs of additional public support for certification programs for landowners or loggers vary with the level and nature of support, but would require either redirected existing funds or new sources of funds for certification audits, as well as funds to public and private entities to administer and implement new or expanded programs.

### *Education*

**Solution: A multi-pronged education effort that encourages sustainable harvesting and discourages liquidation harvesting.**

**Concept:**
Part of an effective effort to substantially eliminate liquidation harvesting includes targeted efforts to educate foresters, loggers, forestland owners, and the general public on the adverse impacts of this practice and how to avoid them. There are numerous opportunities to expand workshops, publications, and media offerings that address liquidation harvesting rules, other forestry and environmental laws, and sustainable forest management practices.

**Implementation:**
As proposed here, the Maine Forest Service would lead an expanded educational effort on liquidation harvesting in partnership with other entities. Additional resources in the form of staff time and contracted services would significantly enhance the effort, if they were available. If no additional resources were forthcoming, added focus on liquidation harvesting would detract from other education and outreach efforts.

**Discussion:**
Several specific avenues may be worth pursuing:

- A media campaign aimed at the general public addressing the liquidation harvesting issue, especially the liquidation harvesting rules and complementary solutions, to raise awareness of the practice itself and efforts to substantially eliminate it.
- A concerted effort to educate all those involved with real estate transactions in basic forest management concepts, an understanding of timber values, and sources of available assistance from public agencies and private foresters. Fact sheets, workshops, and field events would target real estate agents, surveyors, attorneys, tax preparers, and related professionals. Town officials would also benefit from increased information, and are a primary source of information for property owners. The goal is to ensure that all those involved in timberland transactions, and especially prospective buyers and sellers of timberland, have adequate information.
- Licensed Foresters would benefit from more regular information on changes in laws and rules, ongoing enforcement, as well as silvicultural practices, through newsletters (e.g. the Board of Licensure newsletter) and workshops. In particular, intern foresters could be asked or required to develop an understanding of liquidation vs. sustainable harvest practices in the course of their internship.
- Loggers are increasingly organized, providing avenues for printed information, newsletters, and workshops on liquidation and harvest-related issues that directly

affect loggers.

- Undergraduate students in forestry and related natural resource fields could be offered modules relating to liquidation, in the context of silviculture, timber harvest, forest appraisal/valuation, and forest policy coursework.
- Information for the general public via broad media outlets (statewide/regional newspapers, magazines, television, etc) and through multiple organizations could increase attention to the non-sustainable nature of liquidation harvesting.

Establishing education initiatives requires partnership among several entities. The Maine Forest Service is the logical lead agency, with an established education/outreach effort. Multiple partners could include other natural resource agencies, Soil and Water Conservation Districts, University of Maine Cooperative Extension, Maine Municipal Association, the SFI Education Committee, Master Logger, Society of American Foresters, Forest Stewards Guild, SWOAM, the Forest Resource Educators Network, the university's Office of Professional Development, and others.

**Benefits:**
The primary benefit of such an effort is a clear understanding, among involved persons and the general public, of the distinction between sustainable timber harvesting and liquidation, with positive attention directed at the former and negative attention focused on the latter. However, the overall impact of education may be negligible absent other measures to encourage changes in behavior.

**Adverse impacts:**
None anticipated.

**Feasibility:**
This solution would be relatively straightforward to implement, but would require a new/additional focus to MFS's current education/outreach program. An essential ingredient is a commitment from the multiple partners to participate and support the effort.

**Cost:**
The cost of an education initiative could vary. Maine Forest Service could undertake a modest effort with current staff, though not without decreasing emphases in other areas. Other broadly based, comprehensive education/outreach programs have had costs of $200,000 to $400,000 for sustained efforts over 1-3 years. Additional resources through direct contributions and in-kind services from partners would be essential to support the effort. Multi-faceted outreach campaigns have, in recent years, been funded with substantial grants, and such sources could again be sought.

### *Loan Guarantees for Sustainable Forestry Investments*

**<u>Solution</u>: Provide increased access to capital for landowners committed to sustainable forest management to purchase forestland.**

**<u>Concept</u>:**
Guaranteed loans would allow individuals and qualified businesses committed to sustainable forest management to access additional capital to purchase forestland. The Finance Authority of Maine (FAME) would provide guarantees for loans made through conventional lending institutions. In order to qualify, landowners would commit to sustainable forest management for the life of the loan, and enroll the property in the Tree Growth Tax program. Such guarantees would help reduce liquidation harvesting, by making current and prospective landowners with a long planning horizon and a commitment to sustainable forestry more competitive in the market for timberland.

**<u>Implementation</u>:**
Legislative directives are needed to provide guidance and policy clarification to FAME. FAME and MFS would then jointly develop program guidelines, targeted for maximum impact.

An investor would apply to a local lending institution (bank, savings & loan, credit union) for a FAME guaranteed Sustainable Forestry Investment Fund (SFIF) loan. The local bank would administer the loan, which FAME would guarantee. Loans would be for timberland acquisition and allowable tangible improvements to property (under constitutional restrictions on use of bond funds).

A forest management plan would be required as part of the loan application process and undergo state review and approval. As a condition of any loan, the property would be required to enroll in the Maine Tree Growth Tax program by April 1 following the acquisition. All purchasers would of course be required to demonstrate that they will be able to repay the loan.

**<u>Discussion</u>:**
One of the hurdles facing potential forestland investors committed to sustainable forest management is the limited availability and relatively high cost of capital given the generally modest returns from sustainable forest management. Lending institutions typically perceive forest land investments to be risky, and either refuse loan applications, charge high rates of interest, or require high down payments and/or excessive collateral. However, insurance companies and pension funds have recently invested significantly in timberland throughout the northeast. Timber is a non-specialized asset, with a long and steady history of price appreciation.

With a loan guarantee, the risk exposure of banks is lower, typically only 10-20 percent of the loan amount. With this greater certainty of repayment, banks may make loans they otherwise may have rejected, and possibly upon more favorable loan terms, providing investors with improved access to capital.

To prevent an over-concentration within any one industry, FAME would likely cap the size of the forestry loan guarantee program somewhere between $7-10 million. Due to this limit, and a maximum guarantee of $1,000,000 per loan, this should be considered a pilot program, and evaluated for possible wider application.

Enrollment in the Tree Growth Tax program would be required in conjunction with any loan, because it encourages long-term ownership and management.

**Benefits:**
Benefits accrue directly to the forestland investor, in the form of increased access to capital. This will help sustainable forestry investors compete against liquidators in purchasing woodland.

**Adverse impacts:**
The greatest potential risk is from default of loans, which FAME would be obligated to repay. Default on loans is paid from their FAME reserves, but the state could be obligated if widespread losses threaten the solvency of FAME. Loans could be secured by a first position to minimize the downside risk from default. Appropriate underwriting standards should be used to help minimize this risk. Historical rates of loan guarantee defaults across all industry sectors are approximately 1.5%, though they may be higher in the forestry sector alone. Given the history of steady appreciation of forest land in Maine, loans on properties which are sustainably managed should be well collateralized.

**Feasibility:**
FAME is currently authorized to provide loan guarantees through its existing small business loan insurance program. FAME will need to develop appropriate parameters for underwriting standards, loan caps, guarantee percentage, and lending criteria for these investments in sustainably managed forest lands.

FAME currently oversees direct loan programs for agriculture, such as the Potato Marketing Insurance Fund (PMIF) and the Agriculture Marketing Loan Fund (AMLF). A similar direct loan program for forestry investments would further reduce capital costs for borrowers, but at a higher cost to the state, and is not recommended at this time.

**Cost:**
Individual banks will administer loans. The borrower pays routine bank fees, plus a FAME administrative fee (1% of the insured loan amount). Costs to FAME for developing a Sustainable Forestry Investment Fund are currently unknown, but likely on par with other similar programs.

### *Incentives to Consolidate*

**<u>Solution</u>: Provide incentives for landowners to consolidate timberland into larger ownerships and commit to sustainable forestry**

**<u>Concept</u>:**
In conjunction with the "Loan Guarantee" solution for investments in sustainably managed forest land, a variety of incentives could be available to persons wishing to consolidate forest lands for timber management by purchasing abutting forestland. For qualifying lands, the forest management plan required under the Tree Growth Tax program could be delayed for up to 10 years. Real Estate Transfer taxes could also be waived. In order to qualify, landowners would have to acquire lands abutting their own, and enroll the new land into the Tree Growth Tax Law.

**<u>Implementation</u>:**
The proposed incentives would require 1) changes in the law governing the Tree Growth Tax program to provide the additional incentives, and 2) changes in the Real Estate Transfer Tax to provide for appropriate exemptions.

If landowners have an existing parcel in the Tree Growth Tax program, the management plan requirement on the abutting parcel would be waived until such time as the original plan is due for recertification. A revised map identifying the newly enrolled acres would still be required within a year of purchase. (The law currently requires that a new management plan be prepared within one year of sale of a property enrolled in the Tree Growth Tax Program). At the time of recertification, the owner would submit proof that a plan has been prepared for the entire ownership. A signed statement by the owner, that the new parcel is being managed with the same general intent of the original parcel, would be required with the Tree Growth enrollment form. If the management intent of the new parcel were different from that of the original tract, the landowner would create a new management plan or amend the original plan.

The buyer's portion of the real estate transfer fee for the purchase of an abutting parcel could also be waived. Providing the same waiver to the seller could also prove an incentive for sellers to offer timberland to abutting landowners first. To qualify, the buyer would have to enroll both the original and abutting parcels in the Tree Growth Tax program by April 1, following the acquisition.

**<u>Discussion</u>:**
One of the adverse impacts of liquidation harvesting is that land is typically divided into smaller parcels, which are less easily managed for the production of forest products and values. Economies of scale make larger parcels more efficient and profitable to manage. Further, research shows that the owners of smaller parcels are generally less interested in timber management than the owners of larger parcels. This solution aims to reverse the tendency toward parcelization by providing incentives for people to enlarge their ownerships, through reduced transfer taxes and management planning

costs. The Tree Growth Tax program would be used as a central element and tool primarily because it is an existing program with broad landowner participation, it involves only forest land, and encourages long term ownership.

Incentives are intentionally specific to minimize taxpayer costs. Additional incentives could be added to the general framework at any time, with necessarily more expense to the public but greater inducement to landowners. One example of an additional incentive is a property tax rebate program for sustainable forest management recently implemented in Minnesota.

**Benefits:**
Benefits accrue directly to a purchaser of qualifying forestland, in the form of reduced sale fees and management planning costs. Management planning fees are significantly reduced, as no new planning costs are required until the plan update required for the original parcel. Including the new parcel in a single tract Tree Growth plan can offer substantial savings. For a typical 500-acre woodlot, this management planning cost savings could be in the range of $1,000 to $3,000.

An additional benefit is that of the increased efficiency typically afforded by larger ownerships, potentially including decreased management costs, and economies of scale in such areas as contract and materials costs, insurance, and professional fees. Benefits would vary widely depending on scale of ownership.

The Real Estate Transfer Tax is 0.44% of the contract sales price, shared equally by the buyer and seller. For a hypothetical 500-acre woodlot sold for $300,000 ($600/acre), the buyer's share of the transfer tax would be $660 (or just over $1/acre). Though low, this sum might represent up to 30% of the initial management plan cost.

**Adverse impacts:**
None anticipated (see costs). Tree Growth planning requirements are already monitored by individual town assessors. The incentives of this solution, being low, may not induce the preferred behavior of consolidation to any great extent.

**Feasibility:**
This solution would be easy to implement, requiring minor modifications to statutes and reporting forms of the Tree Growth Tax Law, and the Real Estate Tax code. Changes could be made within one year.

**Cost:**
The cost to Maine's financial resources will be minimal given that the revenue loss from waived transfer fees is likely quite small, and the number of eligible land purchases is likely small. In the above hypothetical 500-acre woodlot example , the cost to the State of Maine would be $660 in forgone transfer tax revenue. If 5,000 acres of timberland or approximately $3,000,000 in property transfers were eligible each year, the cost to the state in foregone tax revenue would be $13,200. At the same time, the perception among landowners, particularly those managing timberland, of incentive to enlarge their

ownerships, might provide increased attention to opportunities to purchase adjoining properties for sustainable management.

### *Reduced Taxes on Capital Gains*

**Solution: Reduce Maine income tax rates for capital gains on long-term timberland investments**

**Concept:**
If this proposal were adopted, Maine capital gains tax rates for sale of timberland would be reduced, beginning after 10 years of ownership. At 20 years of ownership capital gains tax rate would be zero under this proposal. Tax reductions would be measured from the date of measure enactment, and not be retroactive. Lower capital gains taxes will improve financial returns of long-term timberland investments, making these investments more competitive with liquidation and other short-term strategies.

**Implementation:**
Maine individual and corporate income taxes are based on the federal adjusted gross income. Implementing the capital gains tax benefit would require changes to Maine's tax code as well as a state income reporting mechanism independent of the federal return. A state tax rebate, credit, or similar mechanism might be simpler and easier to administer than recalculating taxable income. To ensure the perpetuation of forest management, the enabling legislation could limit or preclude gains from the disposition of timberland for development.

**Discussion:**
Due to the discounted value of future cash flows, short-term ownership of any asset, including timberland, can have an advantage over long-term ownership.

A significant portion of the returns associated with timberland investments is capital appreciation. In many cases, the underlying increase in value of the land and timber can account for the majority of returns for the investor. Capital appreciation returns are captured when the timberland is sold.

The large gain associated with the sale of timberlands that have been owned for a long period of time (ten to twenty years and beyond) is taxed at ordinary income rates in Maine. Reduction or elimination of this tax can make the returns associated with long-term ownership more competitive with short-term ownership.

We modeled a hypothetical woodland tract of 5,800 acres. One run simulated long term ownership with a sustainable harvest and sale after 20 years. The other run simulated a short-term ownership that harvested 80% of the volume in 5 years with a sale at year 5. For comparison purchase and sale prices were kept constant at 70% of standing timber value. Tax on the terminal sale was assumed to be 9% (in keeping with capital gains rates). Two capital appreciation rate assumptions were modeled: 6 and 10% nominal. These appreciation rates reflect the range of historic values for Northeast timberland.

The results show that elimination of the tax on the gain at year 20 adds approximately 0.5% to total returns. In the case of 6% appreciation, this puts short and long term ownership on par for returns at 8.9% nominal. At 10% appreciation, long-term ownership actually has a higher return.

There are many assumptions that can change these results. Owners may choose a higher discount rate for long-term ownership to reflect the higher market and regulatory risk associated with longer time frames. In addition, management costs may be higher on sustainably managed tracts — this was not modeled. (Debt is not included in this model because lenders calculate rates and risk based on the owner's financial strength rather than on the value of the timberland or management style.)

**Benefits:**
Reduced capital gains taxes would be a strong incentive for landowners to manage their forestlands for the long term, and remove or reduce the competitive advantage of short-term liquidation and resale.

**Adverse impacts:**
The primary adverse impact would be on state income tax revenue. However, there would be no impact for a minimum of 10 years after enactment.

**Feasibility:**
This proposal would require an administrative framework developed and implemented by Bureau of Revenue Services. Requirements for additional staff time and related administrative costs are unknown.

**Cost:**
Effectively no cost for 10 years. Conceptually, reduced tax revenue from future lands sales would be balanced to some extent by increased tax revenues on timber sales, as sustainable forest management will produce harvests of increasingly higher value timber over time.

### *Encourage Timberland Investment Using Retirement Funds*

**<u>Solution</u>: Promote investment in sustainably managed timberland through self-directed individual or pooled retirement funds.**

**<u>Concept</u>:**
This proposal seeks to encourage investment of retirement funds in sustainably managed timberland. The focus is to educate financial professionals and institutions, especially banks, investment houses and brokerage firms, on the desirable features of timberland investments, and to identify or create appropriate investment models including the account administration functions necessary for individual and pooled timberland investments.

**<u>Implementation</u>:**
Current laws do not specifically prohibit the use of retirement funds in self-directed individual or pooled investments. What is lacking is the expertise and support of financial institutions to advise individuals about such timberland investments, as well as established models of how investments could be structured/administered, especially for pooled accounts. A work group of forestry and financial experts should be assembled to determine how best to develop and implement this solution.

**<u>Discussion</u>:**
Promoting timberland investment as a viable portfolio reallocation tool within a self-directed Individual Retirement Account (IRA) or pooled retirement accounts is a powerful potential vehicle for encouraging long-term investments in timberland. With more than 40% of U.S. households maintaining an IRA, the option for tax deferred (tax free with Roth IRA) investments into timberland using qualified retirement funds has enormous potential. Qualified plans include IRA (traditional and Roth), Simplified Employee Pension (SEP), Education IRA, Keogh Plan, Defined Benefit Plan, and Savings Incentive Match Plan (SIMPLE).

The investment characteristics of timberland and the general portfolio tendencies of IRA holders appear to be a good match. The long-term objectives of retirement accounts offer a near ideal investor profile, and self-directed IRAs would bring this universe of potential buyers to the marketplace. Using IRA funds to invest in real estate requires a few extra steps as opposed to purchasing the more typical stocks and bonds. First, investing in real estate requires a plan administrator. This is typically a bank or trust company that handles the transactions and files the necessary paperwork with the IRS. Secondly, direct management of the asset by investors is prohibited; therefore investors would be more likely to use licensed professional foresters as their "property managers".

An incentive for banks and investment firms to participate could involve linking participation in the "Loan guarantee" programs with a requirement to also establish pooled timberland accounts and offer timberland account administration services to IRA customers. Information on timberland investments is available from a variety of sources.

A second and more intensive approach would be for MFS to develop resources on timberland investment to distribute to interested institutions. MFS and/or a contractor could develop a presentation for banks and investment houses, describing advantages of timberland investment in self directed IRAs, and presenting possible models for establishing and administering timberland accounts. This information could be promoted through a variety of media and venues statewide and beyond.

A primary factor limiting individuals investing retirement funds in forest lands is that most individual retirement accounts are relatively small (generally under two million dollars). Furthermore, it is unlikely that these investors would commit their entire principal to one asset. So the dollar commitment, and thus parcel size for most individual accounts, would tend to be small. For example, $250,000 invested at $500/acre is a 500-acre parcel. Although this scale of parcels may target an important segment of properties prone to liquidation, in the long run emphasis on pooled investments are likely to be more fruitful.

**Benefits**:
A primary benefit relative to liquidation harvesting would be to expand the pool of knowledgeable investors with long-term timber management goals, reducing overall liquidation pressures.

The benefits of tax deferred (or tax exempt) investment returns would accrue directly to the individual investor.

**Adverse impacts:**
There are no known adverse tax impacts of this solution, as IRA timberland investments funds would otherwise be invested in other tax deferred or tax free vehicles.

**Feasibility**:
There are current examples of self-directed IRA timberland investment in Maine, thus we know that such investments are feasible. However, the likelihood of large scale absorption of Maine timberland by IRA holders is small, due largely to a lack of understanding of self directed IRAs along with a shortage of technical expertise and plan administrators in Maine. Education among foresters, trustees and financial advisors is the most critical component in promoting long-term timberland investments within self directed IRAs. One impediment to bringing self directed IRAs to the timberland investment sector is identifying that small portion of IRA investors who maintain accounts capable of purchasing whole real estate investments. Additionally, mechanisms are lacking for persons of modest means to pool their retirement funds for the purchase of forest land, even though there are permitted mechanisms under the IRS rules for "pooled" accounts.

**Cost**:
This solution will require some level of education/outreach funding, depending on the program delivery approach. Costs of a program linked to the Loan Guarantee Proposal (described earlier in this report) would be minimal. Alternatively, information and model development costs, were such efforts to be undertaken, are unknown, but could potentially be established by soliciting proposals from knowledgeable firms/institutions. Similar projects to develop targeted education/outreach programs have been funded at costs ranging from $40,000 to in excess of $100,000. A pooled investment pilot development project near the lower end of this scale could provide an attractive opportunity to seek a grant.

### *Sustainable Forestry Revolving Loan Fund*

**Solution: A revolving loan fund for sustainable forest management costs, including forest management plan expenses and forest certification costs.**

**Concept:**
Implementation of this solution would create a Sustainable Forestry Revolving Loan Fund to enable landowners to develop forest management plans, harvest plans, or to pay for forest certification audits, and allows more landowners to practice sustainable forestry. Loans would be repaid with proceeds from sustainable timber harvests.

**Implementation:**
This proposal would encourage sustainable forest management by providing loans to forestland owners from a revolving loan fund. However, a funding source for such a Sustainable Forestry loan fund has not been identified. If such a fund were established, the Maine Forest Service would administer the fund with assistance from an entity such as FAME with additional financial expertise. Loans would be approved based on fund availability and program guidelines. At a minimum, approved applicants would commit to plans/practices that assure that principles of long-term forest management are addressed. Loan repayment schedules would be set according to project timelines developed between MFS and the landowner. A task force of forestry and financial professionals is needed to work out the specifics of how such a program would function and become self-sustaining. Such an effort should be undertaken when and if a source of funding to capitalize the program can be secured.

**Discussion:**
Some forestland owners do not develop forest management or harvest plans, or pursue forest certification, because they lack capital for these up-front and sometimes considerable costs.

The goals of the program would be to enable forest owners to undertake meaningful forest management and related business planning, develop harvest plans, and/or to pursue independent third-party certification, and spread the costs of such efforts over a longer time period. In many cases delayed repayment would coincide with later timber revenue and thus ease cash flow concerns.

With such measures landowners would likely exceed minimum standards of Tree Growth Tax program and of liquidation harvesting rules. The ability of landowners to assure compliance with these standards and thereby minimize regulatory risk would be an added benefit to participating landowners.

**Benefits:**
Forest landowners would gain access to funds for front-end planning and certification expenses and be able to spread these costs over a longer timeframe more appropriate to returns from sustainable forestry. Such planning would improve attention to long-

term forest management principles, expand certification to more ownerships, and encourage greater professional involvement in management planning.

**Adverse impacts:**
None anticipated.

**Feasibility:**
This solution requires a source of initial loan funds, after which the system would be designed to become self-perpetuating. The solution should be coordinated with related efforts (e.g. the Certification Initiative) and existing landowner assistance programs.

**Cost:**
Costs of the program are primarily for up front establishment of the revolving fund. As an example, an initial loan fund capitalization of $250,000 would fund 50 management plans of $2,000 each and 20 certification audits of $5,000 each, and allow $50,000 for initial program implementation. A larger fund would assure that funds were available for a larger program, perhaps spanning several years, though the length of time before the first loan repayments replenished the fund and were available for additional loans is uncertain. Ultimately the program could theoretically become self-sustaining, with administrative costs funded entirely or in part by a loan application fee..

### *Property Tax Rebates for Sustainable Forestry*

**Solution: Provide property tax rebates for landowners who commit to long-term sustainable forest management.**

**Concept:**
This proposal is loosely modeled after a program recently implemented in Minnesota, and requires further study to determine its potential in Maine. Property tax rebates would be offered to landowners who make a long-term commitment to sustainable forestry, including but above and beyond the basic requirements of the Tree Growth Tax program. As envisioned for Maine, landowners would agree to certain sustainable management practices (see discussion), to not develop the property, and to keep the property in the program for a fixed period. A rebate check would be issued for every year their property is enrolled.

**Implementation:**
Further study and evaluation of this approach is needed. Maine Forest Service would play a key role in developing program specifications, and monitoring of landowner compliance, with assistance on administrative frameworks from Bureau of Revenue Services. Changes to Maine's tax code would be needed.

**Discussion:**
The 2002 Minnesota Sustainable Forest Incentives Act is a part of that state's comprehensive tax revision program. Maine should monitor the effectiveness of the Minnesota program, and continue to study its potential application as a complement to the Tree Growth Tax Law.

Under the Minnesota program, landowners who enroll their land in the program receive an annual incentive check from the state. Landowners agree to have and follow a forest management plan, use state timber harvesting guidelines (i.e., a comprehensive set BMPs), agree to not develop the property, and keep land in the program for a minimum of 8 years. Owners of more than 1,900 acres must allow public non-motorized access. The program enrolled over 500,000 acres in its first year. Landowners received an incentive payment of over $3.00 per acre (higher than the net property tax levied on many of the enrolled forests).

This program has seen high initial success, as it provides a clear and direct incentive to landowners. It is viewed as an inexpensive way to assure multiple public benefits: sustainable forestry, water quality protection, public access, and term easements. Program costs are allocated directly from the state's general fund ($1,500,000 in 2003, plus initial set-up costs of $200,000). The program is administered by the Minnesota Department of Conservation. Landowners make an annual compliance report.

**Benefits:**
Benefits to participating landowners are direct property tax rebate payments. Public

benefits include landowner commitments to water quality protection, public access, and limits to development.

**Adverse impacts:**
None identified specifically. Several parties have expressed concern with any changes that in either appearance or actuality change the provisions of the Tree Growth Tax program. Stability of such programs is a key consideration in assuring their long-term effectiveness. Additional concerns are that municipalities should not bear additional burdens as a result of such programs.

**Feasibility:**
Uncertain. The Minnesota program should be monitored to determine its potential application and feasibility in Maine.

**Cost:**
Uncertain and dependent on the level of rebates permitted.

### *Reduced Estate Taxes*

**<u>Solution</u>: Mitigate estate taxes on timberland owned by individuals, families, or small businesses.**

**<u>Concept</u>:**
Explore mechanisms to mitigate the estate tax burden in those situations/ownerships where estate taxes may have negative impacts on forest management. Such burdens can sometimes require liquidation of an asset that runs counter to objectives of long-term, sustainable forest management. In simple terms, history shows that payment of estate taxes can require sale and subsequent heavy harvest of forest land that has been sustainably managed for long periods of time.

**<u>Implementation</u>:**
Implementing this proposal would require devoting additional effort to exploring the extent to which estate taxes impact long-term forest management, and possible means of minimizing these impacts. A blanket exemption for timberland from estate taxes at the state level is the most extreme example of how these impacts could be addressed, and additional work might provide ideas that are more targeted to particular situations, provide maximum benefit efficiently, and that would represent lower cost to the state in the form of foregone tax revenue. Possible measures could include:

- expanded assistance with estate planning;
- education to raise awareness of existing exemptions and other mechanisms to reduce the impact of estate taxes;
- loans to provide an alternative source of funds to liquidating timber;
- exemptions/elimination of estate taxes in some circumstances.

### *Evaluate the Need for a Capital Gains Penalty for Liquidation Harvesting*

**Solution: Monitor liquidation harvesting and evaluate if other recommended measures are effective, and whether additional measures are needed to ensure that penalties for liquidation harvesting are commensurate with financial gains from the practice.**

**Concept:**
This proposal is to monitor the effectiveness of the measures outlined in this report (once in place), in eliminating the practice of liquidation harvesting. Based on such information, the Department would evaluate whether other measures are needed, such as levying a penalty on gains from the sale or exchange of land where those rules have been violated. The Department's current assessment is that such measures will not be needed for liquidation harvesting as currently defined by the legislature. Rather, the Department expects that other recommendations, combined with active enforcement, will substantially eliminate the practice of liquidation harvesting.

At the same time, practices may evolve that fall outside the current liquidation definition, but also involve rapid turnover of forestland and harvest without regard for long-term forest management principles (e.g. the sequence of cut, buy, sell, and buy, sell, cut referred to earlier in this report). If that proves to be the case, capital gains penalties could be structured to address such situations outside the existing definition. The Department will continue to monitor and report to the Agriculture, Conservation, and Forestry Committee on this subject.

**Implementation:**
This proposal recommends that the level of, and penalties for, liquidation harvesting be monitored. If future assessment of liquidation harvesting shows that rules to "substantially eliminate" the practice, or enforcement of those rules (as described in the section on context) are inadequate, then additional solutions to eliminate financial incentives should be considered. While enacting a capital gains tax penalty or a land speculation tax immediately had support among several members of the Complementary Solutions Committee, the Department does not recommend that it be pursued at this time, for the reasons stated earlier. Additional financial disincentives, if needed, could be implemented via one of several mechanisms.

**Discussion:**
This solution reflects the principle that penalties for the practice of liquidation should outweigh the economic incentives - a principle which we accept, but believe can be accomplished through enforcement of the rules, rather than a new tax. Capital gains from sale of liquidated land often represent a major proportion of the return. Tax penalties that specifically eliminate such gains may ultimately prove a necessary added disincentive, but are not currently recommended.

**Benefits:**
The capital gains penalty, if one were adopted, would complement the liquidation rules by reducing financial gains under a liquidation business model. Where real estate speculation is still driven by rapidly increasing prices, the penalty could provide an additional disincentive to liquidating timber value. If the penalty were based on the actual capital gain relative to the basis, it would be lowest in areas where land prices are increasing least rapidly (least development pressure), and highest in areas of rapidly escalating land prices.

**Adverse impacts:**
To the extent that entities subject to the capital gains penalty (if one were adopted) can pass off some or all of the additional costs to other parties, e.g. by increasing the prices of land sold, the penalties may not prevent all liquidation harvesting.

**Feasibility:**
The mechanism for levying the penalty remains to be established, though several mechanisms have been suggested.

**Cost:**
Costs or potentially the revenues from this solution are unknown.

### *Subdivision of Liquidated Lots*

**Solution**: Prohibit subdivision of liquidated land.

**Concept**:
This solution involves a 5-year prohibition on subdivision of parcels that have been subject to liquidation harvesting in violation of the liquidation rules.

**Implementation**:
The solutions would be implemented by amending 30-A M.R.S.A. 4404 (subdivisions; review criteria), and the corresponding LURC rules, by adding provisions as suggested in the following:

20. Liquidated Lands Prohibited. The subdivision of land that is not in compliance with harvest standards pertaining to liquidation harvesting is prohibited for a period of 5 years from the time of initial purchase. The determination that a proposed subdivision fails to meet these standards shall be made based on either:

- the prior issuance of a citation of violation, consent agreement, or similar enforcement action by the Maine Forest Service, pursuant to Rules promulgated under xxxx, or
- the determination during the review of the subdivision proposal that the land proposed for subdivision is part of a liquidation harvest as defined by law and rule.

The reviewing authority may request technical assistance of Maine Forest Service in making such determination(s).

**Discussion**:
This proposal provides an additional, strong disincentive to liquidation by eliminating opportunities to subdivide liquidated land within 5 years. Subdivision into multiple lots will often maximize profit from sale of liquidated land. Under this provision, if land is harvested in a manner inconsistent with the rules for liquidation harvesting, for the next 5 years it can only be sold intact, without division into multiple lots. The rules as currently contemplated do provide a number of exemptions for sales to relatives, government agencies, etc. These sales would not be affected.

**Benefits**:
This measure creates a strong disincentive to liquidate timberland by limiting land use options if liquidation has taken place. It ties subdivision directly to the liquidation rules, reducing the potential for unanticipated consequences. Additional provisions could close loopholes or limit harvests that have similar impacts to the liquidation rules.

**Adverse impacts**:
The prohibition on subdivision may have negative financial consequences for certain landowners who buy land, harvest heavily, and sell their land within 5 years. Possible negative impacts may be mitigated to a considerable degree by provisions of the liquidation rules that exempt small ownerships and provide alternative means of

meeting the standards.

**Feasibility**:
This solution would require considerable education of all those affected by land use law in general and subdivision review in particular, including landowners, foresters, loggers, municipal officials, attorneys, realtors, and others.

**Cost**:
Costs of implementing the solution would vary by region and for the different entities, and would be difficult to determine for the state as a whole. One concern expressed by some members of the Complementary Solutions Committee is that the solution may present potential costs to a wider spectrum of landowners than those actually involved in liquidation. For example, to keep all their options open, purchasers of timberland may opt to incur the costs for a forester to ensure that any harvesting on newly purchased lands would meet or exceed liquidation rules if sold, even if there are no current plans to subdivide and sell. However, these costs should be modest in comparison to the gains from subdivision, if a subdivision is ultimately undertaken.

### *Other Solutions Considered*

In the course of meetings a number of other potential solutions were presented and discussed. While we believe that each of the following solutions has merit, they tend to have a narrow range of application, less direct impacts, or some other consideration that makes them of secondary importance. As with other proposals, the Stakeholders were not in complete agreement about the merits of these individual solutions. However, they may deserve further consideration and further research as we monitor the effectiveness of other measures proposed to address the issue.

Forest Bank/Land Bank
If such a program were put in place, a forestland owner would "deposit" timber rights and receive a fixed annual return, the funds for which would be generated by a sustainable management program of the pool of Forest Bank properties. This concept has been tried by The Nature Conservancy and others, though without a clear demonstration of success. A Forest Bank could provide landowners an alternative to outright property sale of their forestland, and the risk of liquidation.

Community Forest Bonds
This solution requires enabling legislation at the federal level. The concept is that a non-profit organization would issue tax-free bonds to purchase forestland, with interest and repayment of the bonds funded through timber sale proceeds under a sustainable forest management regime. Once the bond was retired the property would remain a community forest. A conservation easement would be placed on the property to assure the protection of public values, and would be required for tax-exempt status. Community Forest Bonds may provide an alternative market for forestland.

Term Easements
Conservations easements typically are perpetual. Allowing public funding for term easements might encourage more landowners to grant easements, protect threatened resources, buy time for ultimate perpetual land protection, and provide an alternative income source for landowners.

Declining Property Tax
Property taxes that are frozen or reduced over time may encourage long-term forestland ownership. While reducing annual operating expenses, our modeling found that the financial benefits were not as great as reducing capital gains taxes.

## Section IV: Implementation Plan

The Complementary Solutions Committee discussed implementation of these proposals at length in several meetings. These discussions covered the overall approach and ideas for some individual solutions as well. The Committee discussed criteria of desirable solutions and especially the importance of considering feasibility, effectiveness, cost, and immediate vs. long-term impact. <u>However, since consensus could not be achieved, the Department of Conservation, rather than the Group members, is responsible for the following recommendations</u>.

These recommendations are tempered by two key considerations:

- The proposed solutions cannot solve the problem by themselves and truly are a complement to, but not a replacement for, the liquidation harvesting rules.
- Many of the proposed solutions remain in conceptual form, and will require additional discussion, research, and development. Not all of these solutions may prove viable upon more detailed evaluation.

The Department will continue to pursue several efforts outlined in the section on context. Several proposed solutions lend themselves to near term action, while others will require additional study and development.

### A. Ongoing Department Efforts

The Recommendations below must be seen in light of ongoing activities, as outlined earlier in the section on context. In particular, the Administration, via Maine Forest Service, will:

- Continue to monitor liquidation harvesting;
- Refine enforcement of existing laws and pursue modified fine structures;
- Review professional accountability of Licensed Foresters, and;
- Pursue other ongoing efforts addressed earlier.

Through these efforts the Department believes it will be able to increase the likelihood of success in "substantially eliminating" liquidation harvesting.

### *B. Legislative Action to Implement Near-Term Solutions*

Several solutions have potential for implementation and impact in the near term. Specifically, the Department recommends that:

➔ <u>Mill Procurement</u>: The Legislative Committee on Agriculture, Forestry, and Conservation solicit a proposal from the Maine Forest Products Industry as a whole, or its large member companies individually, on how mill procurement policies can be implemented to substantially eliminate liquidation harvesting. Request that it include actionable recommendations to be implemented by the second half of 2004, and subsequent annual reports on the effectiveness of this approach in eliminating liquidation.

➔ Prevent subdivision of liquidated land: The ACF Committee consider the proposed prohibition of subdivision of areas that have been liquidated as a disincentive beyond liquidation rules. Pending legislation (LD 1617) before the Legislature's Natural Resources Committee may provide a vehicle to accomplish this recommendation. (While the capital gains penalty envisions a financial disincentive for liquidation harvesting, this same objective may be realized through this recommendation on subdivision, and through effective enforcement of the rules by Maine Forest Service (as outlined earlier). Monitoring of the effectiveness of this approach may prompt reconsideration of the capital gains solution.)

### *C. Legislative Support for Additional Working Groups*

Additional solutions offer promise but require further development. With the support of the Legislative Oversight Committee, in the form of a legislative resolve, the Department would establish working groups to address specifically 3 subsets of related solutions, within a relatively short timeframe and with authority to bring forward finalized plans for implementation for review by the Legislative Oversight Committee, the Governor, and the Legislature. Such plans should also include needed legislative language for consideration by the Legislature in 2005.

Membership of each working group may include some individuals from the existing Stakeholders Group, but all 3 will require additional private and public sector expertise. An interagency panel including Maine Forest Service could achieve effective integration of the groups' efforts. Alternatively, a single core group could address the solutions below roughly sequentially, with added members with relevant expertise as needed. However, at least one additional full-time contractual or staff person, ideally with expertise in forest finance/economics and management, would be required to coordinate these initiatives effectively. If funding to support this work is not forthcoming, the ability of the Department to make substantial progress in these areas will be limited.

The Working Group efforts would focus on proposed solutions, prioritized as follows. All proposals would likely require legislation to be fully implemented.

Encourage sustainable management
This effort would further develop solutions as outlined earlier to make additional financial resources available to forest landowners who commit to long-term forest management. Coordination with the liquidation rules, related policy initiatives such as the Certification Advisory Team, and with existing MFS programs, would be important. The primary vehicle would be a Sustainable Forestry Revolving Loan Fund to encourage sustainable management practices, as outlined earlier in this report.

Develop incentives to new investment in timberland:
This effort would pursue solutions as outlined earlier to provide additional incentives designed to attract private capital to long-term timberland investment. The primary mechanisms would include loan guarantees, establishing models to invest retirement funds in timberland, and provide incentives to consolidate timberland parcels.

Evaluate tax policies that support long-term ownership:
A working group would review existing and proposed tax policies that could make long-term forest ownership more viable. Specific proposals to be evaluated include reduction of capital gains and estate taxes. This group would also monitor the Minnesota property tax rebate program and consider further development of this concept for Maine if appropriate.

These solutions may require further research and development of implementation plans, funding mechanisms, and the like. Within each work group some solutions may be brought to implementation more quickly than others. If there is legislative support, and the financial and staff resources needed to be effective can be marshaled, all three work groups could be established and begin work in early 2004. It would be incumbent on each group to establish priorities and determine quickly which proposals to pursue, report regularly on progress, and present measures to the legislature as soon as possible. Education is recognized as an important consideration with all solutions, including those that may be implemented in the nearer term.

# Appendix:

APPROVED

JUN 04 '03

BY GOVERNOR

CHAPTER

422

PUBLIC LAW

STATE OF MAINE

IN THE YEAR OF OUR LORD
TWO THOUSAND AND THREE

H.P. 1194 - L.D. 1616

# An Act To Promote Stewardship of Forest Resources

**Be it enacted by the People of the State of Maine as follows:**

PART A

**Sec. A-1. 12 MRSA c. 805, sub-c. 3-A, §8866** is enacted to read:

§8866. Purpose

The Legislature finds and declares that the State's forests are resources of great significance to the people of the State. These resources have great economic value, environmental value, scenic beauty and unique characteristics and unsurpassed recreational, cultural and historical values of present and future benefit to the citizens of the State. The well-being of communities of the State depends upon sustainable forest management. Liquidation harvesting is a serious and direct threat to forest management, forest industries and rural communities over the landscape of Maine. Liquidation harvesting produces significant adverse economic and environmental effects and threatens the health, safety and general welfare of the citizens of the State. Liquidation harvesting is incompatible with responsible forest stewardship and must be substantially eliminated.

**Sec. A-2. 12 MRSA §8868, sub-§6** is enacted to read:

<u>6. **Liquidation harvesting.** "Liquidation harvesting" means the purchase of timberland followed by a harvest that removes most or all commercial value in standing timber, without regard for long-term forest management principles, and the subsequent sale or attempted resale of the harvested land within 5 years.</u>

**Sec. A-3. 12 MRSA §8869, first ¶,** as enacted by PL 1989, c. 555, §10, is amended to read:

To promote a healthy and sustainable forest that contains a balance of age classes necessary for a sustainable timber supply and spatial and compositional diversity, forest harvesting ~~shall be~~ <u>and liquidation harvesting are</u> regulated pursuant to this subchapter.

**Sec. A-4. 12 MRSA §8869, sub-§14** is enacted to read:

<u>14. **Substantial elimination of liquidation harvesting.** The commissioner shall adopt rules to substantially eliminate liquidation harvesting. Rules adopted pursuant to this subsection are major substantive rules as defined in Title 5, chapter 375, subchapter 2-A.</u>

**Sec. A-5. Rulemaking regarding liquidation harvesting.** No later than February 1, 2004, the Commissioner of Conservation shall provisionally adopt rules to substantially eliminate liquidation harvesting by requiring measures that include, without limitation, increased professional involvement in planning and implementation of timber harvesting activities on forest lands.

Rules adopted pursuant to this section must require that timber harvesting activities be conducted with attention to long-term forest management principles. The rules must include appropriate exemptions, including, but not limited to, exemptions for landowners and land managers with independent 3rd-party certification, harvests covering small acreages and permitted land conversions. The rules must apportion appropriate legal responsibilities to landowners, foresters and loggers for compliance with the rules.

The Commissioner of Conservation shall consult with the Commissioner of Environmental Protection and the Commissioner of Inland Fisheries and Wildlife to ensure that Bureau of Forestry rules regarding forestry practices are consistent with environmental and wildlife habitat protection.

Rules adopted pursuant to this section are major substantive rules as defined in the Maine Revised Statutes, Title 5, chapter

375, subchapter 2-A and must be submitted to the Legislature no later than February 1, 2004 for review.

## PART B

**Sec. B-1. Report to Legislature.** No later than January 2, 2004, the Commissioner of Conservation shall report to the Joint Standing Committee on Agriculture, Conservation and Forestry with recommendations and an implementation plan for solutions to the issue of liquidation harvesting. The commissioner shall review, at a minimum, the following:

1. Improvements to standards and guidelines for timber harvests;

2. Increased professional involvement in timber harvests;

3. Improved professional accountability of foresters;

4. Modifications to land use laws;

5. Disincentives to liquidation harvesting;

6. Incentives for landowners who receive independent, 3rd-party certification that their forest lands are well managed;

7. Economic policies to expand markets for forest products harvested from well-managed forests and to promote Maine as a world leader in green-certified forest lands and forest products; and

8. Other relevant approaches.

In conducting the review, the commissioner shall solicit input from representatives of the forestry industry, including professional loggers, state agencies, municipalities, industrial and nonindustrial landowners, environmental groups, financial institutions, Legislators and members of the public.

The final report must include proposed changes to existing laws, rules and policies necessary to implement the recommendations.

**Sec. B-2. Legislation authorized.** The Joint Standing Committee on Agriculture, Conservation and Forestry may report out a bill to the Second Regular Session of the 121st Legislature to implement any or all of the provisions of the plan recommended

under section 1 of this Part or revisions to the plan approved by the committee.