

## Timber in Transition: For Plum Creek, Real Estate Adds Value to Forestlands

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For the longest time, Plum Creek Timber Co. thought of its timberlands as just that: timberlands. But over the years, as the company has grown, it has been forced to think more creatively about its properties. As residential real estate values and population demographics make development an increasingly attractive option, the company must take more development opportunities into account, said Rick Holley, Plum Creek's president and chief executive officer. And then there are recreation options and conservation easements to consider. Still, Plum Creek's primary focus is, and will remain, on its timber assets, and because timber is a long-term resource, the company will continue to make long-term decisions, he said. "What we focus on at Plum Creek is what we think the highest, best, long-term value is of every acre that we own," Holley said. That's a lot of acres. More than 8 million, in fact.

Plum Creek has grown by leaps and bounds since it converted from a master limited partnership into a real estate investment trust, or REIT, in 1999. The new structure opened up the company's stock ownership to more buyers, raising its value and making it easier to raise capital to buy more timberlands. "The reason we did that had nothing to do with the real estate business," Holley said. "It had to do with growth." Plum Creek held 3.2 million acres of timberland when it became a REIT. Within the next two years, it more than doubled its forest acreage, largely because of a \$3.8 billion merger with Georgia-Pacific Corp.'s The Timber Co. It also pushed the company into states it hadn't done business in before, states where some acres held more value as something other than industrial forestland. "It really got us thinking about, rather than only thinking about trees, what is the long-term value for every acre," Holley said. "It's all about thinking about all the different value components of an acre of land, and finding the best long-term value." Real estate, Holley added, has also helped the company grow.

Currently, Plum Creek's real estate activities contribute 30 percent to 35 percent of its total cash flow - a revenue stream the company uses primarily to purchase new timberlands, he said. Plum Creek continues to acquire new lands: In 2006, it bought about 4,400 acres in Arkansas, nearly 88,000 acres in Florida and more than 98,000 acres in Oregon. It also operates 10 manufacturing facilities in the Northwest and sells a variety of forest products. "Today we're the largest private timberland owner in the United States," said Kathy Budinick, the company's spokeswoman. Plum Creek's size is an advantage when it comes to making market decisions, Budinick said: "Because we operate in so many states, and in many different regions across the country, it allows us to make smart operating decisions." For example, if a hurricane or wildfire in one area of the country wipes out a large portion of the company's timberland, it will still have plenty in another area of the country. That's called risk protection. The same principle applies to market forces. If demand for lumber is particularly strong one year, the company can cut timber to service that need. If the lumber market is weak, though, Plum Creek can afford to hold back and wait for prices to improve. "Generally, we have this kind of flexibility because we operate in so many markets," Budinick said. "It's that dynamic, the market forces, if you will, that cause Plum Creek to look at the opportunities associated with (real estate development)."

Out of Plum Creek's total properties, it has identified about 1.7 million acres for use as something other than timber: 975,000 acres for recreation, 500,000 acres for conservation and 225,000 acres for real estate development. The company regularly evaluates its land holdings, Budinick said. It attempts to determine how much of its acreage is best used for timber - or for something else - by considering a myriad of factors, such as proximity to other markets, growing conditions and species, and also whether the property has a scenic view or is near water or recreation areas. "We feel compelled to do this because it's in the interest of our shareholders," Budinick said. Shareholders who invest in timber companies aren't looking for short-term profits, said Steven Chercover, a paper and forest products analyst with D.A. Davidson. These shareholders understand that timber doesn't provide a fast return. Rather, they're hoping for steady, reliable dividends. "There are a lot of shareholders who are very happy to get their dividend every quarter and know the company is growing over the long term," Chercover said.

Plum Creek has three basic divisions: timber and land resources, manufacturing, and real estate and development. Each division is managed under a taxable REIT subsidiary, which is required to pay corporate taxes at regular rates. Plum Creek Land Co., the company's real estate arm, is a wholly owned taxable REIT subsidiary, Holley explained. When the company decides to develop some of its acreage, it sells the land to Plum Creek Land Co. at fair market value. The subsidiary then develops the property and uses any profits to purchase more land for development, he said. Plum Creek Land Co. is overseeing a handful of developments in Montana and other states, he said, including a couple of joint-venture projects in Georgia and Florida. And then there's the Moosehead Lake plan for a 426,000-acre development in Maine. Plum Creek's initial proposal for the subdivision triggered a wave of public condemnation the company has been working to quell. The company is now preparing to submit its application for the Maine development for the third time, Holley said. It has held a lot of community meetings and gathered a lot of input - and is making a lot of changes to the plan, he said: "One of the things we've learned in Maine and other places is, we have to do a better job engaging with the community than we have in the past." The lesson is that reaching out to the community and involving people in Plum Creek's activities ultimately results in a "much better project," Holley said. To that end, the company has put a new executive in charge of community affairs. His job will be to meet with residents and encourage community input. And in fact, Jim Lehner will soon be relocating to the Flathead Valley, where he grew up and where he spent many years working for Plum Creek Timber Co.

The company owns 1.3 million acres in Montana, more land than in any other state. It also has nine manufacturing facilities here and employs 1,446 people in the state, or about 70 percent of the company's total work force. The timber it manages in Montana help feed its wood products facilities, and the company keeps that in mind when making any decisions about its acreage in the state, Budinick said. Right now, timber supply is tight and new housing starts are down, she noted. Unlike many other timber companies, Plum Creek has been able to respond by adjusting shifts rather than cutting jobs. "Job One right now, quite frankly, is to continue to find enough logs to supply our mills," Holley said. That's one of the reasons why, as the company looks toward its future in Montana, it hopes to make more conservation deals, he said. So far, Budinick added, about 150,000 acres of Plum Creek's Montana

land has been put into conservation easements. "Sometimes the best outcome for an acre of land is conservation," Holley continued. "A conservation easement allows us to manage the land for forestry while protecting it from any kind of development in perpetuity." However, western Montana's growth is also likely to demand more residential developments, he added. There's a lot of desire across the nation to own land in "the last best place," he said. Indeed, the nationwide real estate slump projected to slow home price appreciation and new construction isn't hitting certain rural states, said Christopher Chun, a Deutsche Bank paper and forest products analyst who studies Plum Creek. People are looking for vacation property in places like western Montana, and they're willing to pay top dollar for lakefront property. "As a corporation, they have a fiduciary duty to maximize the benefit to their shareholders," Chun pointed out. When timberland is worth maybe \$1,000 an acre but development-worthy acres are selling, as they have been near Kalispell, for \$5,000 an acre or more, it's clear what the company should do, Chun said. A lot of Plum Creek's land, especially near Kalispell and Whitefish, is both beautiful and accessible, and is near enough to population centers to make development a viable option. Even so, Chun added, the company has identified a long-term target of only 225,000 acres out of more than 8 million for development nationwide. "The amount of land they might develop in Montana is still quite small relative to the total amount of land that they have there," he said. "There is only a small percentage of it which is suitable for development. The overwhelming majority of it will remain timberland, where hunting and fishing will go on."