Monetizing the Bare-Land Component of Timberland: Assessment of Opportunities and Agency Issues

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Abstract

Timberland owners have used a number of approaches for monetizing the bare-land component of their timberland without losing the right to grow and harvest timber, including, among others: selling a working-forest conservation easement, selling recreational rights, and selling the surface while retaining cutting rights. In this paper, I will address the latter approach, with an emphasis on the opportunities and challenges associated with alternative structural elements adopted in the arrangement. Institutional investors are accustomed to having various contracting alternatives to modify the attributes of their portfolio assets. Monetizing the bare-land component of timberland provides these investors with the opportunity to modify such attributes as the timber-to-land value ratio, capital at risk, and investment duration.

Some of the structural elements to be assessed will be: retaining term versus perpetual cutting rights, the presence versus absence of a periodic payment to the bare-land owner, inclusion versus absence of a timber-income-based payment to the bare-land owner, and the presence versus absence of a buyback option for the bare-land seller. The primary criterion to be used in assessing these structural elements will be relative agency costs.

Financial economists developed agency theory to analyze the conflicts of interest (and the associated costs) between various groups of principals and agents. Previous applications to forestry have focused on those agency costs which result from separation of timberland ownership from forest management. In this application, the separation of land ownership (the principal group) from cutting-right ownership (the agent group) will result in varying degrees of anticipated conflict of interest.

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