PUBLIC INVESTMENT VEHICLES IN SOUTHERN TIMBERLAND

by

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I have passed out our public offering, Hutton Southern Timber Partner I which most of you have probably seen. It will help point out some of the difficulties that we had in completing it, which I will touch on later.

My experience in forestry investments goes back about 5 years, when I broke away from Hutton's corporate finance department to do real estate syndications in the southeast. I have done a number of private timberland syndications. Included among the investors in those syndications were many officers from E. F. Hutton; they were my natural prospects. After a three year trial period, we were sufficiently well pleased with the experience in our private syndications, for E. F. Hutton, the corporation, to become an equity partner in 60,000 acres of timberland that was acquired in south Georgia. The purpose was to see if a big corporation, with its overhead and management bureaucracy, could still make money in timberland. If so, E. F. Hutton would offer a product for the investing public. Thus, the purpose of buying this 60,000 acres was not to get into the land business on a permanent basis, but to find out if it made sense to develop some kind of product for E. F. Hutton's customers.

Over the last two and one-half years, we have sold somewhat more than 30,000 of the original 60,000 acres and now have something less than 30,000 acres left. The results have been satisfying enough to the firm that about

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one year ago, we decided it was time to take a product to the public. If you read that prospectus for Southern Timber Partners I, you will find that it is a pretty dry, straightforward document. I would guess that as many hours went into putting it together as any other one product that E. F. Hutton has worked on over the last several years. Because we were going it alone in developing our products we did not have someone else's prospectus to cut and paste in order to prepare this offering. Naturally, the first guy out is the one who does the plowing of new ground.

Our idea of a limited partnership was shaped largely by the marketing considerations that were imposed on us by being a retail firm. The first question you might ask is, "Why such a short term?" Normally, a timberland deal should be 20 or 30 years to correspond to the rotation period. However, we came up with what we thought the fundamentals of a timberland offering should be, and then we sat down across the table from the guys who had to sell it (i.e., the salesmen and account executives). Their considerations shape the final form of anything that comes out of retail brokerage firms. The only guidance we had to go on was based on our experience in dealing with other kinds of real estate. Real estate brokers who handle syndications of apartments and commercial buildings everyday are familiar with it. Their customers understand it, so the shape of this particular offering was based on the standard real estate limited partnership. Initially, we thought that the life of the partnership would be 15 years, but the more we talked about it, the more resistance we got from the investors. Although technically the basis on which it was sold is a 15 year partnership, we will strive to liquidate it somewhere around the end of the eighth year. Basically, we have told the investors to trust us for the first five to six years, give us the right to manage the lands,
and let us get the advantage of price appreciation on whatever improvements we make on the lands we acquire. After the fifth year and before the end of the eighth year, we will start disposing of the acquired lands in this partnership. Some of this land may go into other partnerships. In other words, if the markets are not strong enough, we may form additional partnerships to take some of the tracts out of this first partnership so that the investor will have the opportunity to roll his interest forward into a subsequent partnership. The term of the offering is one of the considerations in trying to sell something on a retail basis.

Another consideration was the size of the partnership. We had no earthly idea what the salesmen could sell or what the public wanted to buy. We had seen a very small partnership on the west coast that, I think, did somewhere between $2 and $5 million of business. It was called Forest America, but we did not meet the principals, or have any idea about its success. We also knew that the Rothschilds tried to do one in Europe. They also tried to sell New England hardwoods on the basis of the appreciation that could be expected from buying second home development land. With all of their financial resources, the Rothschilds did only $2 million in business all over the world. That frightened us because, if they could not do more than $2 million, what would we do coming out of the gate. That fear affected us as far as the selection of properties. We literally ended up with a blind pool because we did not know how much money we were going to have to invest.

We could not go and fill $10 million dollars worth of property and sell $3 million worth of the fund. We had thought in terms of $20 million because, at that level, the expenses start getting amortised over the units and the unit cost goes down. At the last minute we decided we should sell $20 million; however, if we put $20 million on the cover of the prospectus and sell only
$18 million, it will be a flop. Thus, we put $10 million on the front, and deep inside the prospectus, we added the right to sell an additional $10 million. Therefore, if we had sold $11 million, it would have been accepted in the face of the public as well as among the sales force. We called the offering Hutton Southern Timber Partners I because we expect to have a series of these. They may not be quite the same, since we may modify the format as we learn.

In any event, back in October we started offering units in the partnership. It was not a project underwritten by E. F. Hutton since the firm was not committed to funding the $10 million they would under a normal underwriting. It was whatever we sold! However, Hutton helped us by providing capital for the venture. Hutton bought the first million dollars of limited partnership interest in sales. In other words, they put a million dollars of hard cash in it. When you are talking to an investor, that helps. If all Hutton is going to do is manage an investment, and if they have nothing at risk, then the offering will not do well. Because we had the first million at risk in the offering, this was a good selling point that helped market the units.

We ran into other problems. For example, how do you tell a salesman to go out and ask his customer to lock his money up for eight years? A brokerage representative likes to have his customer buy and sell on securities. We found a conflict not only in educating the investor to put his money away for that long period of time, but also in convincing the salesman to lock his customer's money up. We approached our people by saying that they should not go after the existing portfolios. This offering should generate new business and new investment money. In other words, the salesman can use it to attract new prospects, as well as to get additional money from existing customers.

With all of that in mind, we proceeded at the end of October, 1981. That is not a good time of the year to start something, because you have the holidays approaching and neither the public nor the salesmen are really in a
hard-working mood from Thanksgiving through the first of the year. We rolled along through November and into December and by about January 5th, we had $10 to $11 million sold. We were only committed to buy a million and one-half dollars worth of property in the prospectus, but once we had the $11 million, we used roughly half of those funds to buy 12,000 acres of land near Pensacola. After that, we put the land description into the prospectus so that salesmen could advertise the Pensacola acreage that we had acquired. With that move, we sold the other $10 million dollars in the next eight business days. This told us that the public wants to see what they are buying. You can tell them all day about how well you are doing, but they want to see the hard assets. We will take that into consideration in the future.

The properties that we acquire will be managed, depending upon where the property is located, in one of three ways. First, if the land is within a convenient radius of our offices in Atlanta or Savannah we will manage it ourselves. Second, if the land is outside of our own operating area, we will use local foresters. Third, in some cases we will use forest paper companies. We are working with an arrangement on one tract which we think will be used over and over again. Under this plan, the paper company does the day to day management, at no cost to us. We bear capital costs, but not the everyday operating costs, and in exchange, we will negotiate with them for year to year cutting contracts. Thus, we are not locked into any price formula; instead, we work on an annual cutting basis using a 10 year management plan for the tract. The plan shows what needs to be harvested and replanted each year. Annually, we will negotiate a lump sum price based on the tract volumes per wood class to be cut. If this price is satisfactory to both parties, we will go ahead with just that portion of the tract for the next year. That gives us the benefit of not having to hire our own people. The company knows when they are going to be able to get the wood and work it into their system. Also, this arrangement
gives us both the right to walk away if we don't like the price and can't get together on it.

In the selection of the properties, we take an initial look at the property with our own people to decide if the price is an acceptable range. If we are satisfied that it is something we want to buy, then our partnership requires us to get an independent consulting forester for an appraisal and a management plan prior to closing on the property. We are obligated to follow the guidelines of that plan after acquisition. We think that gives an investor the protection he needs. We tell our investors not to look for much cash coming out the first five years because we want the right to make the funds work for themselves. The cash flow arrangements in the partnership are similar to those in real estate deals where the investor gets a cumulative 8 percent on his investment. In addition, he gets his investment back first, and the cumulative 8 percent before the general partner participates in proceeds. After the investor has gotten all of his money plus the cumulative 8 percent, the general partner gets 15 percent of all cash thereafter. The limited partners get 85 percent of all the remaining cash.

That has been our public involvement. We will also continue to do private syndications so long as they do not conflict with the public deals. Frankly, we do not want to be out there trying to decide whether a tract should or should not go into the public deal or a private syndication. Since we anticipate that our first fund will be fully committed by the end of June, our salesmen expect the public to be ready for a second offering. Actually, the first one was oversubscribed by a couple of million dollars and investors with the $2 million that was not placed are clamoring for the next one. We hope that interest will continue. Regarding the success of the fund, the key is going to be keeping the cost down as well as having decent markets and taking advan-
tage of the marketing opportunities when they come. Success will also depend on whether we can manage it correctly.