



Oregon Department of Forestry Memorandum

To: Nancy Hirsch
From: Ed DeBlander
Date: March 10, 2008
Subject: January 2008 Common School Forest Land (CSFL) Financial Projection

The January 2008 revenue projection for the Common School Forest Lands reflects improvements to our projection tool based on recommendations made in the Moss Adams Report (see Section 4.). Also included in this projection is a range of future values designed to capture the condition of the current market. This range captures the recovery of the log market at two different rates as predicted by various sources.

Section 1. Revenue Projections

The following revenue pattern using a high and low range of net timber sale revenue may be expected for the Forest Revenue Account.

2007-2009 biennium **\$24,369,000 – HIGH** **\$23,423,000 - LOW**

Six months plus two quarters of actual revenue for fiscal year (FY) 2008 and FY 2009 is driven by booked receivables from sold timber sales, unsold or pipeline sales¹ from FY 2007 Annual Operations Plans (AOP), and the FY08 AOP's.

Fiscal Year	High	Low	July 2007 Projection
FY08-July 1, 2007 to June 30, 2008	\$11,627,000	\$11,497,000	\$14,140,000
FY09-July 1, 2008 to June 30, 2009	\$12,742,000	\$11,926,000	\$14,988,000

The revenue projection for the remainder of the 07-09 biennium is 16% to 19% less than the July 2007 projection. This decrease in the FY08 projection can be attributed to delays in the expected harvest flow of sold sales. The decrease in the FY09 projection is due to a very large decrease in our estimate of stumpage values for the unsold FY08 AOP sales. The average 2008 **AOP stumpage** price estimate is down from \$357 per MBF in July 2007 to \$217 in this current projection.

2009-2011 biennium **\$27,795,000 – HIGH** **\$25,160,000 - LOW**

Fiscal year 2010 and 2011 revenues include estimated receivables from the FY08 AOPs, unsold or pipeline sales from FY07 AOP's, and projected future values. The **future revenue** is calculated by taking an anticipated future volume provided by Districts with a high stumpage price of \$445 per MBF and \$338 for a low.

¹ Definitions for the revenue projection inputs can be found in Section 2.

Fiscal Year	High	Low	July 2007 Projection
FY10-July 1, 2009 to June 30, 2010:	\$10,949,000	10,383,000	\$12,470,000
FY11-July 1, 2010 to June 30, 2011:	\$16,846,000	14,777,000	\$16,724,000

Section 2. Revenue Projection Inputs

The primary objective of these revenue projections is to provide a tool that meets the financial planning needs of the agency and beneficiaries. The revenue projection is a process that takes revenue data from four sources.

- **Sold Timber Sales** – revenues in this category are anticipated receivables from sold timber sale accounts. This category makes up the majority of estimated revenue expected to come in during the last two quarters of FY08 and also contribute to FY09. The Timber Revenue Accounting System (TRAS Q&R) is the source of this data.
- **Pipeline Sales** – these are sales which are not included in the FY08 AOP, but have not yet sold. These may be sales that are on hold due to threatened and endangered species issues, received no bids on their original auction date, or sales from the FY07 AOP which will sell in fiscal 2008.
- **2008 AOP Sales** – these are the sales from the approved FY08 AOP. These sales account for estimated revenue expected in FY 2008 through FY 2013. The timing of when the revenue will be received is estimated based on the termination date of the contract which is determined by the Districts.
- **Future Revenue** - this revenue is calculated using average volumes that each district projects with a stumpage price which is calculated by the Asset Unit in Salem. The lower stumpage prices mentioned in section 1 reflect the assumption that a portion of the volume coming off of the Elliott State Forest will be from first-entry thinnings. The estimated revenue in this category is expected to be received in fiscal periods 2010 through 2014.

Section 3. Assumptions/Specifications/Discussion

As is true with any future projections, revenue projections are estimates that are calculated using a list of assumptions. These projections use the following assumptions:

- Revenue coming in from the Elliott State Forest assumes the approval of a new Habitat Conservation Plan (HCP) in FY10. The projection assumes the Elliott State Forest will operate under a new multi-species HCP, which will raise volume outputs starting in FY10 to 33.9 MMBF per year.
- The projection assumes that pipeline sales will produce revenue through FY13.
- The revenue projection assumes each future CSFL timber sale will be completed within two years, following the trend of terminated sales over the past three years. (Example: timber sales with an expiration date of early FY10, 50% of the volume and revenue are realized in FY08 and 50% in FY09.)
- Because of current poor market conditions ODF has experience a 10% (of value) “no-bid” on sales being offered during the first 2 quarters of FY08. In the low end of the range, we assumed this trend would continue and 10% of the expected AOP value will not sell through the fiscal year. This value has been transferred to the pipeline and the revenue has been pushed back 1 year.

- The Sold Timber Sales category assumes a cut to cruise ratio of 100% for both the high and low range. The cutout ratio applied to the sold timber sale category was calculated on a district by district basis based on the ratio of cut to cruise volume of sales which terminated within the last year. The weighted average of this ratio between all the districts was 93%. The districts felt past factors which have lowered the average cut to cruise ratio will not continue or reflect future ratios. The ODF Timber Revenue Accounting System did not separate the cutout data by fund. Recently, a new tool was created using Access to query sold sales and calculate a ratio of estimated cruised volume versus scaled volume (cutout) split by fund. We will continue to use and refine this CSFL specific data in future forecasts.

- Future estimated CSFL biennial budget (expenditure) to projected revenue ratio for FY08-FY09:

Revenue to Budget (Expenditure)			
Biennium	Estimated Biennial Revenue	Estimated Biennial Expenditure	Expenditure to Revenue Percentage
07-09	\$23.4 to \$24.4 million	\$10.8 million	44%-46%

- Estimated Sale Plan Volume FY06 through FY11:

CSFL (million board feet)			
	ESF	Other	Total
2006 AOP	25.6	10.3	35.9
2007 AOP	16.9	8.7	25.6
2008 AOP	19.8	3.8	23.6
2009-2011 Projections	33.9	6.9	40.8

☐ The 2008 AOP information has been updated to reflect current information and includes one ESF sale sold during the first two quarters totaling 3.9 MMBF. We currently expect to sell all of the above planned volume. Recent discussions with Coos District led to a reduction in the estimated stumpage for future revenues. This stumpage reflects the assumption that a portion of the volume coming off of the Elliot State Forest in this time period will be from first-entry thinnings. This reduction also takes in to account predicted market trends. Our records show the average stumpage price for CSFL sold sales in FY08 was \$463 dropping down from the higher prices seen in FY07 (\$484/MBF) and FY06 (\$496/MBF).

- The attached memo drafted by ODF Staff Economist Gary Lettman describes the current market condition and future trend:

The projection of the long-term trend is based on data from Global Insight Inc., Random Lengths, and interviews of analysts knowledgeable about Oregon's forest products industry.

Current Chairman of the Federal Reserve, Ben Bernake, puts it bluntly: "The economic situation has become distinctly less favorable since last summer." Leading the decline that many economists believe has already put the U.S. economy into a recession has been a downfall in housing-related industries much more severe than previously forecasted. And recovery is now forecasted to take

longer than previously anticipated. Making the problem worse are tightened lending standards, a growing inventory of new and existing homes, and declining housing prices.

Consistent with a deteriorating housing market and with California, leading destination of Oregon's lumber and wood products production, already in an economic recession, the outlook over the next year remains grim. Department of Forestry's log and sawtimber stumpage price trends are projected to remain at relatively low levels. If the country does enter a recession, it may be mild, albeit some economists think the possibility exists that recovery from the recession may be short-lived. Global Insights' February U.S. Economy forecast shows housing starts to hit bottom in 2008, but with a slow recovery that would take years to reach levels expected by favorable demographics of household formation.

The primary product marketed by the Department of Forestry is sawmill grade logs. These logs from State Forests are processed into predominantly dimension lumber and plywood for the housing market. Accordingly, the Department's market trends are largely influenced by the amount of new home construction and home remodeling, mortgage interest rates, and competition from alternative suppliers of logs and sawtimber. Along with housing starts, lumber and log prices have declined dramatically over the last year and prospects for the next several quarters appear grim. Plywood markets have experienced less deterioration than lumber. Log prices are expected to remain weak until there are indications that recovery of the housing market is eminent.

Bright spots include high chip prices and increasing exports of lumber and wood products. With decreased lumber production has come a scarcity of chips and increasing prices and chipping of smaller logs that would have otherwise gone to lumber production. Although accounting for a relatively small portion of Oregon's forest economy, wood products exports from Oregon increased by 13% in 2007.

Low levels of housing starts and anemic economic growth are expected to result on continued downward pressure on lumber prices, with recovery in lumber, plywood, and log prices tied to an economic turnaround and improving housing starts. Recovery may be delayed if the housing-related problems continue to spill over to other segments of the U.S economy.

Section 4. Moss Adams Report Recommendations

In June of 2006 Moss Adams, LLC was awarded a contract to conduct a performance audit of the State Forests Revenue Projection. Both phases of this audit have been completed and ODF staff has utilized many of these recommendations in this revenue projection.

cc: Marvin Brown, State Forester
Clark Seely, Associate State Forester
Jim Paul, Forest Management Division Chief
Mark Hubbard, Business Services Director
James Scarce, Budget Analyst
Nancy Hirsch, State Forests Deputy Chief
Ed DeBlander, Asset Unit Manager
Area Directors

Common School Fund High and Low Range Revenue Projection

