

Appendix C:

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MINISTRY OF FORESTS
BRITISH COLUMBIA FOREST SERVICE
BRIEFING NOTE

File: 280-20/19700-25/TFL 39/44

I PREPARED FOR:

(as requested by Bob Friesen)

II ISSUE:

Deletion of Weyerhaeuser's Private Land from Tree Farm Licenses 39 and 46

III BACKGROUND

Weyerhaeuser has formally requested that the Ministry delete Weyerhaeuser's private land, presently incorporated within Tree Farm Licenses (TFLs) 39 and 46, from those TFLs. The private land in question encompasses some 90,000 hectares, mainly on Vancouver Island. A map and legal description of these lands are attached.

General Background

Private lands within TFLs are managed "as if" they were Crown forest lands with the exception that timber harvested from such land does not bear stumpage. Deletion of the lands from the TFL would mean that they are no longer subject to the Forest Act (in particular AAC restrictions and Crown log export controls), Forest and Range Practices Act and other legislation applying to public forest lands. They would become private managed forest land. Weyerhaeuser could subsequently apply to have selected parcels removed from the Forest Land Reserve.

The inclusion of private lands within TFLs was encouraged in the 1940's and 1950's as part of a policy thrust for sustained yield forest management; by agreeing to include their private lands within TFLs, companies were provided additional rights to public timber.

Within the last several years, however, private land owners have become more interested in taking their private lands outside the public forest management system. In 1998 almost all of TimberWest's private land was removed from TFLs 46 and 47. In addition to the current Weyerhaeuser request, TimberWest is also now requesting that its remaining private lands be deleted—this request is the subject of a separate briefing note. Attachment A summarizes the current private land holdings within TFLs. It

is likely that many of these would also pursue deletion if the opportunity arose.

Weyerhaeuser 1999 Deletion Proposal

In 1999 a similar deletion request from Weyerhaeuser (then McMillan-Bloedel or MB) was considered. The context at that time was the out-of-court settlement of MB's compensation claim.

Land Use Plan. The Settlement Agreement specified an agreed settlement amount (\$83.75 million) but gave the Province the option to pay in the form of either cash or "land"—"land" being some combination of private land deletions and Crown tenure conversions to fee simple totalling \$83.75 million in value.

The parties jointly commissioned independent appraisals of the subject lands; yielding an estimated value of approximately \$18 million for the private land deletions. The Province also conducted a series of public meetings to obtain public input on the settlement proposal.

The public meetings revealed a strong negative reaction to the proposal. In part, the opposition was an organized response by environmental NGOs opposed in principle to what they perceived as an initial thrust to privatization of the public forest. However, there was also a strong local component to the opposition based on specific local issues. This opposition remained strong despite good faith efforts on the part of MB to accommodate local interests.

Following the public meetings the government elected to pay MB in cash.

IV DISCUSSION

Deletion as a Policy Issue

It is generally accepted that private land should be managed to achieve certain minimum standards but that it need not be managed to achieve as wide a variety of (non-market) values as is public land.

Deletion means that private lands that have been managed "as if" they were public lands will become managed as the private lands they have always been.

At one level this change is simply a matter of contract: the government and the landowner made a contract decades ago to manage the land as if it were public; deletion undoes that contract. Since the initial contract involved consideration—the award by government to the landowner of timber rights on Crown land—it would seem that the landowner should be able to buy out of that contract by providing appropriate consideration in

return. That done, the end result—private land managed as private land—would seem acceptable.

Three considerations complicate this picture:

1. Over time, the general public becomes conditioned to the public management of the land in some cases becoming active users for controls.

The consideration paid by the landowner to "buy out" the contract does not compensate these groups for the changes they experience.

2. Experience suggests that the appraisal profession treats intangible assets quite conservatively, creating a downward bias to the appraised values of deletions. Given the above, such valuations are vulnerable to criticism from the affected public.

Government faces the unenviable choice between (a) procedurally defensible but substantively vulnerable appraisals; or (b) possibly higher negotiated settlements that cannot, however, be independently supported in the face of public criticism.

3. Deletion could also become a flash point, triggering a larger public debate on government's intentions with respect to "privatizing" public tenures.

Legal Authority to Delete Private Lands from TFLs

Notwithstanding the foregoing discussion of the conceptual contract between the government and Weyerhaeuser, there is currently no legal authority to delete private lands from TFLs. Legislative changes introduced in 2003 inadvertently restricted the power to amend TFLs to sub-divisions and consolidations (in which the total AAC is unaffected). A legislative amendment to address this situation is planned for the 2004 Spring Legislative Session.

Implications for Forest Management

Deletion has a number of implications for forest management. These impacts can be: (a) accepted as consistent with a private land designation and, where appropriate, factored into the valuation of the deletion; or (b) addressed or mitigated by agreement with Weyerhaeuser, bearing in mind that this could affect the valuation. Mitigation has limited use because it requires an ongoing government role where enforcement tools and resources may be lacking. However, for certain types of issue, such as public access through Weyerhaeuser land to otherwise isolated Crown land, specific agreements are needed.

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Prior to a deletion decision, a comprehensive summary of cross-government (and, where possible, public) issues, together with suggested management strategies, can be provided.

Consideration for Deletion

...in exchange for increased access to crown harvesting rights, suggest that it should be possible for private land owners to buy out of the arrangement. However there is no legislation, present or planned, that would govern the consideration for this type of transaction. In the absence of such legislation, the following types of "good government" principles could be applied:

- equitable treatment of all similarly situated private land owners
- fair market valuations on both sides of the transaction, the deletion itself and the consideration (if not cash)
- transparency—formal appraisals or independent fairness opinions (of negotiated settlements).

V OPTIONS

All of the options below assume that the government will pass legislation in the Spring 2004 Legislative Session authorizing the deletion of private lands from TFLs.

Option 1: Facilitate Weyerhaeuser Deletion Request:

Establish a government team to work with Weyerhaeuser to address key issues relating to the terms and conditions for deletion with a view to completing this work as soon as practicable. This could include some public consultation; however, extensive or formal public consultation is not contemplated in this option.

- responds quickly and constructively to Weyerhaeuser's request
- may prevent NAFTA litigation related to Timber Licence royalty legislation
- will be criticized for excluding the public
- creates platform for NGOs on forest privatization issue

Option 2: Place Onus on Weyerhaeuser

Advise Weyerhaeuser that government will only consider a deletion request: (a) if Weyerhaeuser can demonstrate a satisfactory level of public support; and (b) on terms and conditions acceptable to government.

- maintains government decision options pending more complete information

- increased risk that deletion will not occur, hence loss of potential benefits to government from this "currency":
 - a "back up" strategy for dealing with NAFTA litigation threat will be needed
- risk that public controversy associated with issue will still attach to government

Advise Weyerhaeuser that government is not prepared to consider its deletion request at this time.

- defers controversial issue, until possibly more opportune time
- does not advance the substantive resolution of government policy in this area
- could affect Weyerhaeuser business decisions respecting its coastal operations, unless Weyerhaeuser understanding/support for deferral is obtained
- likely to require another strategy for dealing with NAFTA litigation threat.

VI RECOMMENDATION:

Option 3

APPROVED/NOT APPROVED
The Honourable Michael de Jong
Minister of Forests – FOR DECISION

Date

Enclosure(s):

Attachment(s):

charged with that responsibility had the foresight and financial ability to accumulate in their hands these alienated lands, especially on the Coast, and more particularly in the Vancouver Forest District. These lands are now held in great part by their corporate successors as trustees for their thousands of shareholders and investors.

It is true, of course, that large acreages of unalienated forest land remained in the Crown, but, in general, the remaining areas of mature forests on the Coast lay on hillsides above the rich valleys, and were of poorer-quality timber. Some remaining areas carried stands of fine timber, but in instances difficult of access because of the strategic locations of alienated timber. Other areas were remote and without access by waterways or existing roads.

The system of temporary tenures, whereby timber lands reverted to the Crown when logged, did not offer any inducement to the operators to do other than cut off their mature timber (unless they could afford to hold it) and then move on to other areas, without regard to the productivity of the land and its capacity to produce a continuous crop of timber. Operators, in order to maintain production, simply "cut out and got out." They were transients, consuming the forest as they went along, without any permanent interest in the land they cut over and continually migrating to other sources of supply. The practice of private forestry was, unfortunately, neither contemplated nor encouraged by these forms of temporary tenures. Such a situation could only lead to ultimate disaster.

Responsible officers of the Forest Service were aware of the danger—so were the managers of large corporations with millions of dollars invested in conversion plants. It was in consequence of this apprehension that I was appointed in 1943 as a Royal Commissioner to investigate and report upon the forests and forest industry of the Province.

After lengthy hearings I reached certain conclusions, and in December of 1945, in consequence of these conclusions, I made a series of recommendations. As the 1945 Report is out of print, I reproduce, in part, some of the relevant observations in that Report:—

"At present our forest resources might be visualized as a slowly descending spiral. That picture must be changed to an ascending spiral. Differently phrased, we must change over from the present system of unmanaged and unregulated liquidation of our forested areas to a planned and regulated policy of forest management, leading eventually to a programme ensuring a sustained yield from all our productive land area.

"The expression 'sustained yield' now requires explanation. Although professional foresters, when treating this subject, appear to have much the same mental concept, their definitions do not always agree. The disagreements, however, appear to me to be more of scope than of substance, and arise, for instance, from the endeavour to include within

the definition reference to silviculture requirements and multiple forest uses.

"Silviculture can, and will, increase the yield and the optimum yield would result from an intensive use of the productive capacity of the area. A sustained-yield policy has, as one objective, the maintenance of forest cover and growth, thus ensuring a perpetual supply of raw material for forest industries, with consequent stability of industrial communities and assurance of permanent pay-rolls.

"A no less important objective is the perpetuation of the forest-cover to assure the continuance of the many direct and indirect benefits which flow therefrom in addition to the mere growing of wood. In my view, however, none of these factors is a necessary or essential ingredient of the definition to be applied to the term 'sustained yield.'

"I would define 'sustained yield' to mean a perpetual yield of wood of commercially usable quality from regional areas in yearly or periodic quantities of equal or increasing volume. That is my understanding of the concept expressed in its basic form.

"That, then, must be our objective: To so manage our forests that all our forest land is sustaining a perpetual yield of timber to the fullest extent of its productive capacity. When that is accomplished all benefits, direct and indirect, of a sustained-yield management policy will be realized; providing, of course, that the multiple purpose of our forests is recognized as an aim as important as balancing cut and increment.

"In my opening remarks I made mention of the main contributions our forest makes to our economic and social welfare. May I repeat here that a sustained-yield policy, perpetuating our forest stands, will not only provide a continuity of wood-supply essential to maintain our forest industries, primary and secondary, with consequent regional stability of employment, but will also ensure a continued forest-cover adequate to perform the invaluable functions of watershed protection, stream-flow and run-off control, the prevention of soil erosion, and of providing recreational and scenic areas, and a home for our wild bird and animal life.

"Our forest industries have been living on an expenditure of forest capital that has taken hundreds of years to accumulate at no cost to industry. The time has now come when we have to plan to live on forest interest and maintain our capital unimpaired. How are we to accomplish this purpose?

"I propose to deal with the subject under the various headings below, but the order in which they appear is not to be taken as an indication of the relative importance of each heading, but rather as indicative of the relative urgency needed in the implementation of each recommendation.

- “(1) Fire-protection must be greatly increased.
- “(2) The rate of planting denuded areas of productive forest land—especially on the Coast—must be greatly increased.
- “(3) Logging methods must be regulated to prevent destructive exploitation and to ensure full regeneration of cut-over lands.
- “(4) New systems of tenure and taxation need be formulated to encourage private forestry and to remove causes compelling liquidation.
- “(5) Management plans for individual regional working circles should be formulated and implemented by regulation.
- “(6) There must be a more intensified research in and practise of silvicultural methods.
- “(7) Facilities and funds must be provided for extensive forestry research.

“It must not be thought that, as and when the objectives outlined above are reached, the forests of this Province will then be on a sustained-yield basis. That desired end cannot be reached until our mature timber on the Coast is cut and the area now covered by that old growth—which might just as well be in piles in a lumber-yard as in the forest, so far as increment is concerned—is growing a new forest. But unless we do plant our denuded areas and secure regeneration of our cut-over lands and protect our new growth from fire, we can never hope to save our forest wealth from inevitable extinction, much less succeed in attaining a sustained-yield forest production. There is much to be done and the start must be made at once before it is too late. The whole is the sum of its parts, and if we succeed in setting up working circles, region by region, the day will come, and it will not be long, when the people of this Province can, with pride of achievement, hand down to their sons, and their son’s sons for all time to come, the wealth and benefits of our forest land in all its growing beauty.

“Under our present system of temporary alienations of timber lands that revert to the Crown when logged, operators who cut these lands to secure raw material for their own conversion units are offered no encouragement to treat these lands as permanent tree-farms producing continuous crops. They are, therefore, of necessity forced to move from one area to another to maintain production—‘cutting out and getting out.’ Responsible operators with large investments in sawmills and pulp and paper plants realize that this process cannot keep on indefinitely. They feel that the time has come when, in order to be assured of a continuous supply of raw material for their plants, a new industry must be created—the use of the productive capacity of the land for the growing of forest crops.

“The first step toward this objective would be a form of tenure permitting the operator to retain possession in perpetuity of the land now

held under temporary forms of alienation, upon condition that he maintain these lands continuously productive and regulate the cut therefrom on a sustained-yield basis.

"I think I can safely say, upon the evidence before me, no operator has a sufficient supply of timber in reserve to permit him to maintain an economic production of lumber from those areas under his control if he were compelled to cut on a sustained-yield basis either now or in the second crop rotation.

"It seems to me the only practical solution to this problem lies in the allocation of Crown timber."

The basic problem that we had to resolve in 1945 was how to bring about, in an orderly fashion, this concept of sustained yield and forest management, which was to replace the system of unmanaged liquidation of our forest resource.

As demonstrated by the historical review of past alienation, millions of acres of highly productive land on the Coast, in large part in strategic locations, were in private hands in various forms of tenure, permanent, as in Crown grants, or in temporary forms of alienation.

Unless and until these lands were brought under a sustained-yield programme, then the objectives outlined in the 1945 Report could not be achieved. It was this inherited pattern of ownership that loomed large in the path. In 1945 I said:—

" . . . it seems to me an inescapable conclusion that the great part of the alienated timber resources of this Province are controlled by a comparatively few men. The success of any future forest policy designed to place our forests under a system of planned management must depend, to a degree, upon the extent to which these holders co-operate with the Crown in a mutual endeavour to reach that objective. . . ."

There were four courses open: One, to admit our inability to meet the challenge and to continue on a liquidation basis to probable economic disaster within the foreseeable future. Two, to cancel or refuse to renew all temporary tenures, which would mean a repudiation by the Government of existing contracts and renewal rights thereunder. Three, to devise a form of contract whereby the holder of private lands held by him in fee or on temporary tenures would agree to manage these lands on a sustained-yield basis and surrender his right to liquidate as he pleased, provided the Crown allocated to him contiguous and suitable areas of unalienated Crown timber so that the total combined areas, when on sustained yield, would provide a substantial proportion of the raw material required by him to maintain his production—title to the whole area to remain in the Crown, except acreage previously held in fee, and the management of the total area to be subject to Crown control. Or, four, to depart from a long continued policy and convert by outright sale the temporary tenures when cut over into

some form of permanent title, to which might be added Crown areas sold or alienated on some permanent basis to make up sustained-yield units.

It would have been unwise, in my opinion, to suggest the adoption of proposition one, two, or four. Public opinion would not, in 1945, in my belief, support a policy of continued liquidation, nor repudiation of existing contracts. Neither would a recommendation that Crown timber lands be permanently alienated have met with general public approval at that time.

That left the partnership concept as the only rational selection for a future forest policy wherein the Crown, in order to ensure the desired objectives, would retain full control and regulation of the areas included in the partnership contract. In consequence I felt impelled to make this recommendation, which in due course led to the formulation of the present forest management licence policy.

In one sense the heavy hand of the past pressed down upon the Forest Service in its effort to carry out the basic intent of the plan: the large and long-existing private ownership pattern determined the location of the contributory forest management areas. A forest management licence is primarily a device designed to enable and encourage the practice of sustained-yield forestry by private interests on those privately held tenures and, in addition, shifts from the Forest Service to industry the costly burden of forest management of the previously unalienated Crown forest land included in the licence area, the overriding control still, however, remaining in the Crown, as owner of the land. Sustained yield in this sense means that our forests will be a continuous and increasingly valuable asset, with long-term benefits to the economy of the Province. An assured continuity of supply of raw material results in the construction, maintenance, and uninterrupted operation of costly integrated conversion plants, ensuring the highest utilization return for the logs cut with attendant competitive advantages in world markets. This, in turn, should result in a maximum continuity of employment in all phases of the industry—logging, transportation, and conversion into the end product.

Continuity of employment has, as its sequel, stable, settled, and prosperous communities. Then, too, indirect benefits flowing from a sustained-yield policy are of great consequence and are felt in almost every branch of our Provincial economy.

The forest management licence system was devised as a vehicle of policy to effectuate this concept of sustained yield with all these and other consequential benefits.

The forest management licence, while securing to the licensee an assurance of the continuity of supply of a percentage of his wood requirements measured in terms of productive capacity, compels him, in consideration thereof, to assume burdens not imposed upon him by any other form of tenure.

Contrary to the views expressed by those opposing the system of forest management licences as a "give away" of our resources, it is not a one-way street. I shall, however, return to this aspect and others later when discussing in detail forest management licences and the objections thereto voiced during the Inquiry.

Having set up a system to provide for a sustained-yield programme on privately held lands and included unalienated Crown lands, there remained the problem of extending this principle to the still remaining unalienated Crown lands.

To this end and upon consideration of the evidence adduced, I recommended, in the 1945 Report, the creation of public working circles. These public working circles had their historic origin and legislative sanction in the Provincial forest reserves established under provisions of the "Forest Act" of 1912, of which preliminary working-plan surveys had been made since 1925. This recommendation could thus be implemented through administrative action by the Forest Service without further specific statutory provisions relating thereto.

An important segment of the forest industry is composed of sawmills and other small conversion units, which have no reserve of timber-supplies of their own. There is, in addition, an independent group of loggers who do not wish to manage timbered areas, and who have no conversion units of their own. The public working circles were areas to be managed on a sustained-yield basis by the Forest Service, wherein the independent logger could buy timber and produce logs for this class of sawmill. On the Coast an open log market was the link joining these two groups together. Of recent years, the open log market and position of the independent market logger have, to a degree, undergone some alterations or modifications—subjects to be dealt with at a later stage of this Report. It is also apparent that holders of forest management licences, and especially those who have increased their mill capacity, are now looking to the public working circles to supply that portion of their requirements not provided for by the allowable cut in the licensed areas.

However that may be the underlying reason for setting up public working circles was the necessity of bringing unalienated Crown lands within the sustained-yield programme of management under the Forest Service and at the public expense.

**Analysis of Additional Value Associated with
Removing Private Land from TFLs 39 and 44**

June 30, 1999

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1. Terms of Reference

On May 19, 1999, Ernst and Young Corporate Finance Inc. ("Ernst and Young") was contracted by the Province of British Columbia ("the Province") as an independent consultant to estimate the additional value that MacMillan Bloedel Limited ("MB"), acting reasonably and prudently, could be expected to realize if some of its private lands were removed from its tree farm licences ("TFLs"). Ernst & Young engaged the services of Olympic Resource Management ("ORM") and R&S Rogers Consulting Inc., to provide the technical and regulatory expertise required under the contract with the Province. This draft report estimates the incremental value to MB, given the scope provided in the Terms of Reference.

The Terms of Reference were prepared by both MB and the Province through an iterative process. The Terms of Reference required the consultant to separately value the following specified private land aggregations:

- TFL 44: east of the E&N line, and north of the Alberni Inlet, including the Beaver Creek area;
- TFL 44: east of the E&N line, and south of the Alberni Inlet;
- TFL 44: west of the E&N line;
- TFL 39: if the consultant believes that the values per hectare for the properties in the Queen Charlotte Islands ("QCI") are significantly different from the remainder of the TFL 39 properties, then the QCI "block" should be appraised separately from the remainder of the TFL properties. If the consultant feels that the difference in values per hectare for the QCI "block" and the remainder of the TFL 39 properties are insignificant, then all of the TFL 39 properties should be appraised as one "block"

Each valuation is to include a total value and the value per hectare for each of the four or five blocks in question. The report will include:

- a) maps of the candidate land to be removed from the TFLs;
- b) descriptions of the current state and condition of the identified parcels and the natural resources they contain;
- c) confirmation that the lands are in the Forest Land Reserve;
- d) an explanation of the components of additional value to MB;
- e) a description of the methodology and data used to estimate the net present value, on an after-tax basis, of the future stream of additional value; and
- f) documentation of any data used in the appraisal that was not provided by MB or the Ministry of Forests.

Considerations

The analysis is to examine, but is not necessarily limited to, the financial implications of the private lands in question no longer being subject to:

- allowable annual cut determinations and associated statutory or contractual cut control requirements; and (1)
- strategic and operational planning rules and constraints under the Forest Practices Code; (2)

and instead, being subject to:

- the pending Private Land Forest Practices Regulation, and
- any other generally applicable regulatory requirements that will remain in effect.

Additional considerations are to include:

- TimberWest comparable valuations, ORM – December 9, 1997¹, H&W Saunders Associates Ltd. – May 30, 1998²; ✓
- specific Government operational constraints on these private lands, such as public access and ungulate management;
- short-term risk of changes to the draft Private Land Forest Practices Regulation;
- possible implications of tenure reform; and ✓
- the trend in changes to operating cost differences between operating under the Private Land Forest Practices Regulation and under the Forest Practices Code as it applies to lands within a TFL.

The consultants are to document the private lands which would no longer be subject to Provincial log export controls or fee-in-lieu of manufacture if it were removed from the TFLs, and are to estimate a value to MB of such a change.

The analysis is to take into account technical and market factors that affect MB's ability to take advantage of the changed regulatory regime. It is also to consider any self-imposed operating constraints that MB, acting as a reasonable and prudent operator, might employ for the purposes of the sustaining public support for its operations and forestalling new restrictive regulations on its operations. NB

Technical Parameters

The financial analysis is to assume the following parameters:

- a time horizon of at least twenty years with provision for calculating a terminal value;

¹ BC Crown – TimberWest Forest Limited, Vancouver Island, Goal 2 Land Exchange, Timber Appraisal. December 9, 1997, ORM (formerly Simons Reid Collins).

² Analysis of the Financial Implications of Deleting Private Land from Tree Farm Licences 46 and 47, May 30, 1998, H&W Saunders Associates Ltd.

- a real (inflation-adjusted) after-tax discount rate of eight percent; or an equivalent nominal rate of ten percent; and
- domestic log values according to the Ministry's historical data over the last twelve years.

Sensitivity Analyses

- The consultants may undertake whatever sensitivity analyses that is felt to be appropriate, and may express the value as a range rather than a single number.

The draft report is to be delivered to MB and the Province on June 18, 1999 in preparation to review the report at a joint meeting with Ernst and Young on June 22, 1999.

A final report is to be delivered to MB and the Province on June 30, 1999.

Caution

The consultants did not audit, review, or attempt to verify the accuracy or completeness of the financial information, projections, or other information provided to us.

We have not expressed an opinion or other form of assurance on the financial information or projections. Moreover, this report cannot provide assurance that matters of significance to the financial information or to the Province and MB's due diligence will be disclosed. This report should not be taken as a replacement for other inquiries and procedures that the Province and MB should undertake as part of their own due diligence activity.

In addition, our report may not be appropriate for use by any party other than the Province and MB. Items of possible interest to any other third party may not have been specifically addressed. Therefore, we accept no responsibility for damages, if any, suffered by any other party as a result of decisions made or actions based on this report.

2. Executive Summary

The purpose of this Executive Summary is to provide MB and the Province with a summary of our analysis, methodology and conclusions with respect to the work performed in accordance with the Terms of Reference. The Executive Summary has been organized as follows:

2.1 Overview of Engagement

2.2 Methodology

2.3 Context and Assumptions

2.4 Conclusions

Following the review of the Executive Summary, it is our recommendation that both Parties review the report in its entirety, including appendices, before making any conclusions regarding the incremental value of transferring the private lands out of TFL #44 and TFL #39.

2.1 Overview of Engagement

The Province and MB have agreed to consider the removal of up to about 90,000 hectares (ha) of private land from two of MB's tree farm licences (TFLs): TFL #39 and TFL #44. Removing the Private Land (or Schedule A Land³) would decrease the administrative requirements and costs related to managing these lands and also change some operational constraints imposed under Provincial legislation.

Through a contract with the Province, the Province and MB have engaged Ernst and Young and ORM to estimate the additional value that MB, acting reasonably and prudently, could be expected to realize if some of its private lands were removed from its TFLs. The blocks of land under review are private land owned by MB that are under the regulatory control of the TFL. By removing this private land, the government is not selling Crown land, rather it is discharging some of its regulatory control. This transaction, although unique, is not unprecedented. In 1998, the government transferred 61,000 hectares of TimberWest's private land out of TFLs #46 and #47.

Background

During the period of 1991 to 1995, MB lost its timber harvesting rights on approximately 7,663 hectares of timber licences and on an additional 43,877 hectares of Crown land within two TFLs and ~~on an additional 43,877 hectares of Crown land within two TFLs and~~ MB have been on-going since December 1997 in order to settle MB's claim in accordance with the parameters specified in the Forest Act.

On March 16, 1999, the Province and MB reached a Settlement Agreement. The Settlement Agreement requires the Province to pay MB \$83.75 million in resource rights, land and/or cash as

³ Private Land and Schedule A Land are used interchangeably in this report.

compensation for the lost harvesting rights. The compensation may consist of one or more of the following non-cash currencies as compensation:

- the incremental value from the removal of about 90,000 hectares of MB's privately held land from two of MB's tree farm licences;
- the transfer of some of the Vancouver Island Plantation (VIP) lands between Duncan and Campbell River as fee-simple ownership; and
- the transfer of fee-simple ownership of some of the Crown land currently within TFL #39.

If the above non-cash currencies are not used as full compensation, the Province must pay the remainder in cash in monthly instalments over a period of up to five years.

This report is the first step in assessing the use of the above non-cash currencies in the Province's fulfilment of the Settlement Agreement. In May 1999, MB and the Province jointly issued a Request for Proposal to engage an independent consultant to estimate the additional value associated with removing private land from TFLs #39 and #44.

- On May 15, Ernst and Young, in conjunction with ORM, submitted a proposal to act as the independent consultant for the valuation;
- MB and the Province jointly selected Ernst and Young/ORM as the independent consultants to value the incremental value of removing MB's private land from its TFL;
- Ernst and Young engaged a forest industry consultant to assist in the valuation process;
- On May 20, MB and the Province, made presentations to the consultant outlining in greater detail the proposed regulatory change and allowing the consultant to ask further questions regarding the scope of the engagement;
- Data and information were provided by MB and the Province as outlined in the Terms of Reference;
- Map reviews of each block were performed at MB by the consultant;
- Accompanied by members of both MB and the Province, the consultant performed aerial inspections of TFL #44 and the TFL #39 properties in the Queen Charlotte Islands on June 3 and June 8, respectively. An on-the-ground inspection of the remaining areas of TFL #39 occurred on June 21;
- The draft report was delivered to both the Province and MB on June 18, 1999. A joint meeting of MB, the Province and the consultant was held on June 22 to review the draft report;
- This final report is to be delivered to MB and the Province on June 30, 1999.

2.2 Methodology

The value of transferring the Private Lands out of TFLs #44 and #39 is derived by using the discounted cash flow ("DCF") methodology of calculating the net present value of future incremental cash flows. The DCF is used because this is a unique transaction and there is only one other similar transaction that has occurred in BC.

The land under consideration was divided into the following blocks:

1. TFL #44 – North;
2. TFL #44 – South;
3. TFL #44 – West;
4. TFL #39 – QCI; and
5. TFL #39 – Remainder.

Cash flows to MB from removing its Schedule A Lands from TFLs #44 and #39 are calculated by assessing the incremental cash flows of the following three components:

1. **Harvesting Rate Benefit:** The removal of the Private Lands from the TFLs and cut control regulations could allow MB to increase the harvest. This would increase the cash flows and thus the value of the lands.
2. **Regulatory Cost Savings Benefit:** The removal of the Private Lands from the TFLs would allow MB to reduce a portion of the costs of Provincial regulations that are not required on unencumbered private lands.
3. **Log Exportability Benefit:** The removal of the lands from the TFLs would allow MB to export logs while avoiding the fee-in-lieu of manufacturing. This would only apply to those Private Lands granted before March 12, 1906. However, the log exports would be subject to the surplus testing requirements under Federal regulations.

Annual cash flows for each component are a multiple of the projected harvest rates ($m^3/year$) and unit values ($\$/m^3$). The same harvest rates are used for the three components and thus they are interdependent. However, the estimates of unit values are mutually exclusive to prevent the double counting of benefits.

These cash flows are discounted to January 1, 1999 using a discount rate of 8%, which was agreed on by MB and the Province. Since the Terms of Reference does not specify a valuation date, January 1, 1999 was determined to be the valuation date for the following reasons:

- the Province and MB agreed to settle MB's claim to compensation under the *Carmanah Pacific Park Act* and for the creation of new parks and the *Klanawah Ecological Reserve* as of January 1, 1999;
- interest accrues to MB beginning January 1, 1999 until the date of payment; and
- the values of the VIP lands and the Schedule B lands are to be determined as of January 1, 1999.

Terminal values were considered, but no values are assigned in the DCFs because of the high degree of uncertainty in estimating cash flows from an intangible asset 20 years from now.

Incremental cash flows are calculated for all of the property groups on an individual basis and on an aggregate basis. Values are estimated for the five property groups in addition to a value estimate for all the properties combined. Descriptions of the property groups and maps are in Appendix I.

Once the DCF estimation is calculated, it is tested for reasonableness by comparing it with the TimberWest valuation—the only other major Schedule A Land transfer in BC.⁴

2.3 Context and Assumptions

We are aware of the high public profile of this valuation and that a wide range of viewpoints exists regarding the settlement process, or aspects of value. As consultants, we have been asked to carry out a specific assignment, the Terms of Reference for which are detailed elsewhere in this report. We have done so using methodologies that have wide general acceptance. We have based our analyses on what we believe to be plausible assumptions based on various factors, such as our experience, in-depth knowledge of the industry, comparable transactions and our knowledge of forest management practices. We have performed sensitivity analysis and considered “what if” situations to the extent that they pertain to our specific Terms of Reference.

We highlight the following important concepts.

- The land being valued is not publicly owned Crown forest land. It is private land, owned by MB, which was combined many years ago along with some public lands into the TFLs.
- As part of an already agreed upon amount of compensation (\$83.75 million) for the loss of cutting rights elsewhere, the two parties involved can settle for cash payment or can agree to an alternative arrangement. As a possible alternative of settling in cash, the two parties have agreed to look at other options. The focus of this valuation report is that the two parties have agreed to consider (nothing has yet been finalized) the removal of up to about 90,000 hectares of private land already owned by MB from two TFLs held under its name.
- The Province points out that, if this withdrawal occurred, MB would benefit in several ways. Our job is to determine the value of these various benefits to MB.
- More specifically, the purpose of our report is to provide an independent, arms length valuation to the two parties involved. In doing so, it is not correct to view this report as a valuation of publicly owned timberland being provided to MB as part of the agreed compensation amount. Rather, we have to determine a very specific success or potential benefit to the

⁴ The TimberWest value determined in 1998 was calculated using similar DCF methodology.

as they pertain to MB. Precisely, we have to determine the value to the owner (MB) of removing the private land in question from two of MB's TFLs (TFL #39 and TFL #44).

- There are many assumptions involved in the valuation. Many of these have been provided to us in the Terms of Reference included in Appendix VI. For others, we have made these explicit and have either provided the justification for them or explained our rationale.
- As already noted, we are providing a notional value of an intangible asset; the regulatory rights governing private lands in two TFLs. These rights and their effects on cash flows cannot be precisely defined or assessed. We are not appraising a real asset and the values reported are not indicative of the price of Crown or private timberlands.
- This valuation is a point in time estimate given existing regulations on public land (i.e., Forest Practices Code), draft regulations on private lands. Furthermore, there is no consideration in our estimates regarding the potential for change in the tenure system. Any changes in the above would obviously have a material effect on our valuation.
- This valuation is based on the premise of value to owner – specifically MB acting as a reasonable and prudent operator. We have considered the self-imposed operating constraints that MB would likely employ to sustain public support for its operations and forestall new restrictive regulations on private lands. The report does not provide an estimate of fair market value, particularly in the context of the highest price obtainable in an open market. Higher values may be possible assuming another company employed fewer operating constraints.
- There are inherent difficulties associated with valuing this intangible asset. There is no market where the rights of regulating private lands in TFLs are traded. (There has been only one previous transaction involving the transfer of Schedule A Lands.) This leaves the income approach, but it involves a high degree of uncertainty and risk, as forest management regulations on TFLs are a result of public policy, which changes over time.
- We have provided a range of values as both parties had requested this. The range is fairly wide as it reflects the difficulty in appraising an intangible asset.
- We have not considered two important effects of transferring the Schedule A Lands:
 1. The changes to the allowable annual cuts and operating plans of the Crown lands remaining in the TFLs; and
 2. The synergies and operating benefits of combining the Schedule A Lands with MB's unencumbered private lands in Managed Forest Unit #19 (MFU #19).

The analysis of these effects was beyond the scope of our report.

2.4 Conclusions

Based on the discounted cash flow analyses, it is our view that the value to MB of transferring the whole of their Schedule A Lands out of the TFLs, is worth between \$15.4 million and \$31.8 million, as at January 1, 1999. The estimated values for the whole land base and the individual property groups are shown in Table 2-1. (The values for the whole land base differ from the sum of the values for the individual property groups because there are synergies generated by combining the property groups)

Table 2-1: Values to MB of Transferring the Schedule A Lands

TFL		Property Group	Range of Values	
TFL		Property Group	Low	High
Whole Land Base			15,355,000	31,769,000
Components:				
TFL #44	North	7,408,000	18,883,000	
	South	3,057,000	8,640,000	
	West	1,000,000	2,863,000	
Sub-total TFL #44			11,473,000	27,996,000
TFL #39	QCI	1,848,000	3,984,000	
	Remainder	1,401,000	2,092,000	
Sub-total TFL #39			3,349,000	6,056,000
Components - total			14,822,000	34,052,000

consistently excellent quality. Programs like these let us produce more timber off the same land base, and that will continue to increase our yield.”

A Large, Private Log Supply

With 2.4 million cubic metres of long-run sustainable yield, TimberWest already enjoys unparalleled access to private timber and its many advantages. Nearly two thirds of its logs now come from private lands, whereas most B.C. companies rely entirely on stumpage-bearing Crown timber.


Erik Bentsen, Senior Vice President Coast Logging, explains that logs from private lands provide a major cost advantage because they are free from stumpage charges and the government’s costly regulatory processes. Private timberlands also provide a much higher degree of operational flexibility than Crown tenures.

“Our private lands let us do what other industries take for granted,” says Bentsen. “They let us respond quickly to market needs because we’re not constrained by the paperwork that slows operations on Crown tenures. We also have greater freedom to match logs to individual customers – both in B.C. and around the world.”

The freedom to sell logs to a full range of customers proved critical in 1998’s tough market conditions.

TimberWest produces logs that fall into three broad market categories: domestic saw logs, pulp logs and export logs. John Kelvin, the company’s Manager, Log Trading says that while prices in each of these markets were depressed last year, there were opportunities nonetheless. According to Kelvin, ongoing demand for second-growth Douglas fir delivered a significant premium over hemlock/balsam, particularly in export markets.

OPTIMIZING “RETURN TO TREE”
Douglas Fir Prices by Sort (1998)

Old Growth			Second Growth		
	Pulp	\$44/m ³		Pulp	\$44/m ³
	Utility	\$56/m ³		Chip n’ Saw	\$47/m ³
	Gang	\$74/m ³		Gang	\$74/m ³
	Standard	\$124/m ³		Standard	\$90/m ³
	Peeler	\$196/m ³		Peeler	\$99/m ³
	Export	\$259/m ³		Export	\$157/m ³
	Hi Grade	\$426/m ³			

“Fully 45 per cent of TimberWest’s total merchantable timber inventory is made up of Douglas fir,” says Kelvin. “We had both the right log mix and the ability to take advantage of those premiums.”

Kelvin adds that opportunities also arose from the market trend towards smaller log inventories.

“As log customers move to tighter and tighter inventories to reduce their working capital requirements, they can run into problems when inventories become too low. At that point, customers will pay a premium to the supplier that can help them solve their inventory problems quickly,” says Kelvin.

TimberWest has learned to be that supplier.

Harvesting Operations

Responding to windows of opportunity has meant adopting a new style of operating – one that shares more in common with modern manufacturing facilities than with traditional logging operations.

Says Manager Production Planning, Rory Hill, “In essence, we’re applying just-in-time market approaches into

our logging operations. This involves keeping close tabs on what kind of logs the market wants us to provide, and having the means to go and produce them very quickly.”

Information is the key. In recent years, TimberWest has compiled extensive timber inventory and harvest planning information onto its computer systems. New 20-year plans are providing an even clearer picture of individual stand values and the operating flexibility related to each one.



Kevin Kyle, Engineer



For immediate release: August 8, 2007

9,700-hectare land purchase protects future drinking water supply for CRD residents, and adds to regional park system

Victoria (BC) – The Capital Regional District (CRD) is purchasing more than 9,700 hectares of land from TimberWest Forest Corp. to protect the future of the region's drinking water supply and to substantially add to the region's park system.

The agreement involves two separate parcels of land. The land for the water supply is located west of the existing Sooke water supply lands. At 8,791 hectares, the Leech River watershed nearly doubles the CRD's water supply area. The second parcel, 932 hectares for new regional park land, is located east of the Sooke Potholes Regional Park and is being purchased with support from The Land Conservancy of British Columbia (TLC).

"This is one of the largest, most important land acquisitions in recent BC history. The addition of the Leech River watershed, which can be connected to the CRD's water supply reservoirs, is a prudent strategic acquisition that secures and protects our future water source," said Nils Jensen, Chair of the CRD Regional Water Supply Commission. "While the Sooke Reservoir is expected to meet regional water needs for at least the next 15 years, we have taken action that provides a legacy for the future."

"TimberWest is delighted that our former properties in the Leech River watershed will help preserve the quality of life in the capital region," said Paul McElligott, President and CEO, TimberWest Forest Corp. "This land transaction is another example of our company's commitment to work with our neighbours in a socially responsible manner."

"The new park land is a significant addition to the 7,400 hectares already dedicated to the Sea-to-Sea Green Blue Belt, southern Vancouver Island's ecological highway of protected, park wilderness connecting Sooke Basin to Saanich Inlet," said John Ranns, Vice Chair of CRD Parks Committee. "I would like to thank The Land Conservancy of British Columbia for their financial contribution to this project and its ongoing commitment to help achieve the vision for the regional park system in the capital region."

"We are pleased to have played a role in adding to the Sea-to-Sea Green Blue Belt," said Bill Turner, Executive Director of The Land Conservancy of British Columbia. "Helping secure this land is a source of great pride for all of us involved with TLC and builds on our past financial contributions to the purchase of Sooke Potholes and land in the Sooke Hills for regional parks."

With this purchase the CRD will manage nearly 20,000 hectares of land dedicated to the protection of the region's water supply. The purchase also allows the CRD to avoid substantial future capital costs of more than \$150 million associated with the construction and operation of a new water treatment facility.

The purchase of the land for regional parks will increase the total regional park area to nearly 11,400 hectares. This accounts for approximately 50 per cent of all the protected lands in the capital region.

The transaction is valued at \$64.7 million, of which \$58.9 million is for the Leech River watershed. It will be funded through an increase in the wholesale water rate that will cost the average household about \$23 per year. The purchase price for the second parcel dedicated for park use is \$5.8 million, financed by the CRD's land acquisition fund and a \$500,000 contribution from TLC.

The CRD will borrow funds to complete the deal and it will therefore be subject to the assent of the electorate. The deal is expected to close before the end of year.

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