Forest Lands Taxation Advisory Subcommittee Breakout Meeting Minutes 09/27/2021

Committee Members Present:	**Department of Revenue Staff:**
Gordy Sanders Sen. Mike Cuffe Paul McKenzie Randy Mannix	Scott Mendenhall, Deputy Director-DOR Kory Hofland-PAD Bonnie Hamilton-Management Analyst, PAD Bill Billman-PAD Dylan Cole-PAD Ed Caplis-PAD Robin Rude-PAD Bryce Kaatz-PAD
Public:	**Presenters:** Dr. Jackson-Professor Emeritus Resource Economics & Policy

I. Meeting began at 1:33 PM. Dr. Jackson stated he would explain his timber appraisal methods and reasoning including why he used certain data and disallowed other data. He discussed the two tasks he focused on: determining tax appraisal zone, and a stumpage price within each zone. He was initially concerned about creating zones due to the constraints of the zones. He considered zones and prices together, rather than one, then the other.

II. Dr. Jackson stated that most timber sales and logging are west of the Continental Divide, but he had to appraise timber in eastern Montana, so he pooled the population and then chose zones from that limited population. He discussed the three accepted methods of appraisal: comparable sales approach, investment approach, and a cost analysis which usually refers to replacement cost. He mentioned the various other factors, including timber prices, management costs, productivity estimates, and cap rates.

III. Dr. Jackson discussed some detail about the regression process and explained that he used DNRC prices because they report standing timber prices. He believes the Forest Service purchase system is very complicated, both contractually and managerially. He gave some examples of why he does not consider Forest Service prices. He stated that in his experience BBER delivered log price predictions don’t match stumpage prices and gave some theories for this. He stated that a lot of price variation depends on marketing.

IV. Dr. Jackson stated that “back in the day”, every non-industrial land owner had to have a harvest reduction agreement with the option of assistance from a forest service forester. The landowner also reported their own stumpage prices. Mills and owners of large land had master reduction agreements. There are questions on how to analyze this information, but if those details were worked out, it would create a robust representation of the timber sold on private and non-industrial lands. He went on to discuss why he doesn’t believe private forest prices shouldn’t be too high.

V. Dr. Jackson believed the cap rate is too high (Scott Mendenhall clarified that Dr. Jackson had meant to say he believed the cap rate is too low). When the assessment program was originally created, risk items such as wild fires and bug-free green timber were not considered, even though productivity and price are based on green timber. He believes it would be difficult and expensive to try to analyze such risk factors, so concludes that perhaps the cap rate should be bumped up a bit to compensate for the lack of such an analysis.

VI. Sen. Cuffe asked for a better explanation of cap rates. Kory Hofland stated the current rate is 8% (by statute, this is a minimum), and that the lower the cap rate, the higher the value. Discussion ensued. Dr. Jackson stated that raising the cap rate would be a simple way to adjust for risk.

VII. Robin Rude asked if hazard reduction agreements are still required with every timber sale. Dr. Jackson stated he believes that is still the case. Gordy Sanders stated there are hazard reduction agreements that can be taken out by a logger, landowner, or a consultant. The agreements are reported to DNRC. Gordy Sanders stated that prices among the separate parties may not be shared among them.

VIII. Bryce Kaatz asked for some background on the limited sample size on DNRC sales, the criteria by which they were excluded. Dr. Jackson described an example in which a landowner would not allow the state to use their property to access the land for logging. He went on to say that he doesn't use transactions where there were no bids, bug sales, or salvage sales. Dylan Cole asked to clarify that an arms-length transaction would require at least two bids.

IX. Kory Hofland asked Dr. Jackson why he did not consider insect sales or salvage sales. Dr. Jackson stated that he didn't consider them because productivity is based on green timber growth.

X. Dr. Jackson stated there is more risk now than when the forest tax system began. Productivity has gone down due to fires and insects, the number of mills decreased, and timber sources changed greatly. Forest harvest declined and industrial harvest peaked and then sloped off.

XI. Gordy Sanders asked Dr. Jackson about forest management expense and how it was accounted for in the different zones. Dr. Jackson answered that forest management in eastern Montana is likely very hands-off and that logs need to travel much further today than they did years ago. Further discussion about costs ensued. Dr. Jackson departed the meeting.

XII. Bryce Kaatz began a discussion regarding the DNRC sales and that there may be a premium that private landowners are not receiving. Paul McKenzie agreed with Dr. Jackson that this is a very difficult problem to solve and went on to discuss all the variables that may go in to determining one stumpage value per zone. He stated that he believes the pool of sales should be larger and there should be fewer disallowed sales even though they might not be considered arms-length. He also suggested reducing the exclusion of certain sales via other agencies. Kory Hofland suggested adjusting the cap rate based on size premium.

XIII. Discussion ensued regarding considering forest service and state sales, and the tangible vs. intangible costs and how to account for the costs. It was discussed that salvage sales and bug sales may need to be included if there aren't enough green sales to make a good representation of what is available for comparison.

XIV. There was a general discussion about accounting for species in zones and how to also account for species in sales. Further discussion included normalization of accounting of species. Dylan Cole stated that he believes the regression model accounts for species per zone.

XV. The suggestion was made that all sales be analyzed by the current models to see what the results are, then determine how they should be adjusted. Ed Caplis agreed to head this effort. Discussion ensued regarding approach to collecting data and which data to use. There was also discussion about rules and statute regarding cap rate and adjustments to the rate.

XVI. It was decided there would be an October subcommittee meeting for updates on the study of data, sources of data, cap rates, etc.