# Final Report to the Governor

# Governor's Task Force on the Competitiveness of Minnesota's Primary Forest Products Industry

**December 15, 2006**

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## Executive Summary

The primary forest products industry is vital to Minnesota's economy, as well as to the health and management of both public and private forests. The industry provides jobs and economic activity that benefit communities statewide, but especially rural communities in northern Minnesota. Commercial timber harvest is also critical to realizing many wildlife habitat and other recreational benefits on public and private forests, and helps prevent the loss of private forestland to other uses by providing revenue to landowners.

The value of product output from Minnesota's primary forest industry more than doubled between the 1970s and 1990s. The situation in 2006 stands in stark contrast. Instead of new jobs, there are job losses from machine shut downs, mill closings and disinvestments (i.e., industry investments going to other states and countries). Contributing factors include extremely high stumpage costs and slumping housing markets, among others.

The Forest Products Industry Task Force, originally convened in 2003, was reconvened by the Governor in the fall of 2006. The Task Force identified nine issues and 31 near-term recommendations[1] to help resolve these issues and increase the competitiveness of Minnesota's forest industry. Many counties, the DNR and the USDA Forest Service have already responded to this critical situation by taking various administrative actions (see Appendix 2, p. 16). The Task Force strongly urges the Governor, however, to pursue the additional administrative and legislative actions recommended in this report (see Near-term

[1] Near-term recommendations include administrative and legislative actions that should be taken between December 2006 and the end of the 2007 Minnesota legislative session.

Recommendations, p. 5-9). The most urgent administrative actions are related to the wood and fiber availability and price issue.

Because of the need to focus on immediate administrative actions and the limited time available for its deliberations, the Task Force did not develop long-term recommendations.[2] As a result, the Task Force requests that the Governor reconvene the group between January and May 2007 so it can identify and make long-term recommendations to address primary forest products industry competitiveness. Further, the Task Force requests that the Governor create a follow-up team made up of high-level decision makers to formulate a comprehensive strategy to implement both near- and long-term recommendations.

## Background and Statement of Need

The primary forest products industry is vital to Minnesota's economy and forest health. The industry employs over 22,000 people in the state, and directly and indirectly supports many thousands of additional jobs. The industry is especially important to rural Minnesota, where highly paid jobs are important to local economies.

Because forest management is largely accomplished through commercial timber harvest, the forest industry plays a vital role in realizing many wildlife habitat and other environmental and recreational benefits on our state's public and private forests, and reduced losses to insects and disease. In recent years, forest industries, county land departments and the DNR have placed major emphasis on forest certification, resulting in over six million acres of certified forestland in Minnesota and higher quality environmental stewardship of these lands. In addition, timber markets provided by a healthy industry assure a steady, long-term source of timber sale income for private forestland owners, thereby reducing the temptation to pursue more immediate revenues from the parcelization, sale and eventual conversion of their lands.

The value of product output from Minnesota's primary forest industry more than doubled between the 1970s and 1990s. Investments in this industry brought new jobs and additional economic activity that benefited northern communities as well as the Twin Cities.

The situation in 2006 stands in stark contrast. Economic challenges have been confronting Minnesota's forest products industry in waves. Instead of new jobs, there are job losses from machine shut downs, mill closings and disinvestments (i.e., industry investments going to other states and countries). Extremely high stumpage costs, increasing energy costs, high transportation costs, increasing logging costs (some of which have been accepted as a result of voluntary guidelines and certification programs), challenging global competition for paper manufacturing, decreasing demand for wood products as a result of slumping housing markets and historical high capital investment needs are a few of these challenges.

During the bulk of the 1980s and 1990s, Minnesota was largely insulated from market related production curtailments because of low raw material costs and new state of the art production facilities. This is no longer the case. Paper, lumber, engineered wood and logging capacity have all been temporarily idled or permanently lost this decade. As the logging work force ages and more operators go out of business, the issue of declining logging infrastructure has become acute.

[2] Long-term recommendations include administrative and legislative actions that should be taken following the end of the 2007 Minnesota legislative session.

Some of the factors contributing to these losses, such as the decline in the national housing market and low manufacturing costs in other countries, are beyond Minnesota's control. Other factors, including timber supply (and hence cost), truck and rail competitiveness, state and county forest management decisions, and state and local tax policies, can be directly controlled by Minnesotans.

In order to have an economically vibrant forest products industry that allows public and private land managers the opportunity to achieve desired future conditions for their forests as well as jobs and economic opportunity in rural Minnesota, those factors that can be influenced or dealt with in Minnesota must be addressed.

## Governor's Charge to Task Force

Responding to the current situation, Governor Pawlenty reconvened the Task Force on the Competitiveness of Minnesota's Primary Forestry Products Industry, which he had originally formed in 2003. He presented the Task Force with a two-fold charge:

- Develop near- and long-term recommendations to retain and increase the competitiveness of Minnesota's forest industry.
- Recommendations and rationale for recommendations communicated in writing to the Governor by December 15, 2006.

## Issues

The Task Force identified the following nine issues that should be addressed by near-term actions. A tenth issue, energy, requires long-term rather than near-term action, and thus is not addressed in this section.

**Issue A: Wood and fiber availability and price**

1. The system used by public agencies to price timber does not work well during rapidly decreasing markets. Important results include the following:
   a) People are holding contracts they cannot afford to execute.
   b) Stumpage prices in recently offered public agency contracts do not reflect current market conditions.
2. Public agencies do not supply the market with a sufficient amount and quality of wood, leading to increased prices.
3. Timber sales methods employed by public agencies tend to inflate stumpage prices.
4. There is a large amount of mature timber available on non-industrial private forestland that is not being made available for sale.

**Issue B: Maintenance of working forestland base**

1. Blocks of private forestland are being parcelized and are under development pressure, leading to reduced opportunities for timber production and other benefits.
2. Private forest landowners lack adequate education, resources and incentives to manage their land.

**Issue C: Forestland productivity/health**

1. Public agency timber management decisions use best available data, which may be outdated, insufficient or incorrect.
2. There is a general lack of investment in silvicultural activities.
3. There is a general lack of investment in forest modeling practices for planning that would enhance productivity.

4. Public agencies may not manage their land to capture growth and minimize mortality, due in part to competing stakeholder interests, budgets and missions.

**Issue D: Professional capacity (loggers, resource managers)**
1. The current timber market conditions will lead to the loss of loggers and logging infrastructure.
2. Public agencies and private entities employ an insufficient number of foresters and resource managers for timber sale preparation and silvicultural practices.

**Issue E: Transportation (trucks weights and captive rail)**
1. Continued high transportation costs in Minnesota (both truck and rail) put Minnesota businesses at a competitive disadvantage.

**Issue F: Permitting and environmental review**
1. Compared to other states and countries, the environmental review and permitting processes in Minnesota are costly, unpredictable, inconsistent with established environmental practices and take a long time to complete.

**Issue G: Taxation**
1. State sales tax policy needs to better encourage investments in capital equipment.
2. State property tax policy does not adequately encourage and may discourage timber harvesting or forestland retention.
3. Tax incentives are needed for modernizing plant and logging infrastructure.

**Issue H: Research**
1. There is a lack of adequate research information about wood fiber pricing, analysis of timber markets, value-added manufacturing, biomass energy viability, planning models and the value of forest management in Minnesota.

**Issues I: Public attention/knowledge**
1. There is minimal public support for the forest products industry due to a general misunderstanding and lack of knowledge about the importance, issues, needs and contributions of the industry.

## Near-Term Recommendations

Based on the information presented in this report and its deliberations over the past two months, the Governor's Task Force on Minnesota's Primary Forest Products Industry makes the following near-term recommendations[3] to address the issues the Task Force has identified. The agency or organizations that should be assigned responsibility for the action are noted in parentheses after each recommendation. The recommendations are not ranked, and the order in which they are listed does not imply priority.

### Wood and Fiber Availability and Price

*Administrative Actions*
1. Strongly urge the counties to offer 850,000 cords for sale (versus approximately 700,000 cords offered in 2005) on an annual basis and to sell both this year's and last year's planned sales (County boards).

[3] Near-term recommendations include administrative and legislative actions that should be taken between December 2006 and the end of the 2007 Minnesota legislative session.

2. Direct the DNR and strongly urge the counties and National Forests to re-sell timber and re-offer returned sales as quickly as possible and not count them as part of the current year's timber sale plan (DNR, county boards, USDA Forest Service).

3. Direct DNR to maintain its timber sales program at planned levels, to continue re-offering unsold wood on the market and accelerate the harvest of high risk, low volume stands (DNR).

4. Direct the DNR to conduct an initial analysis of whether and how one million cords of wood may be offered for sale from DNR timberlands on an annual basis while maintaining needed reforestation on a continuous basis. Deliver results of the preliminary analysis and a plan for achieving an increased timber harvest goal to the Governor by March 1, 2007 so that the information can inform and influence the agency budgeting process (DNR).

5. Strongly urge National Forests to sell both this year's and last year's sales. Specifically, urge the Superior National Forest to sell its Fiscal Year 2007 target of 65 million board feet (mmbf) and the 23 mmbf in unsold sales from Fiscal Year 2006 for a total of 88 mmbf during the current Fiscal Year. Strongly urge the Chippewa National Forest to sell its Fiscal Year 2007 target of 35 mmbf and the 2.3 mmbf in unsold sales from Fiscal Year 2006 for a total of 37.3 mmbf during the current Fiscal Year. Strongly urge both National Forests to aggressively move to selling the annual Allowable Sale Quantity in their Forest Plans (Superior National Forest - 102 mmbf; Chippewa National Forest – 57 mmbf) by FY 2009 (USDA Forest Service).

6. Direct DNR and encourage county and federal land managers to immediately begin offering more wood for sale at optimum economic rotation ages. This should be done to the extent that it does not preclude Extended Rotation Forestry (ERF) projections utilized as mitigations in the *Generic Environmental Impact Statement on Forest Management and Timber Harvesting* (1994) (DNR, county boards, USDA Forest Service).

    A. Public.forest managers should utilize rotation ages that reflect the optimum economic rotation age for their normal management activities (DNR, county boards, USDA Forest Service).
    B. The DNR should immediately set an upper limit of 30% for extended rotation prescriptions utilizing normal rotation ages within its Sustainable Forest Resource Management Plans. Counties should not allocate acres to extended rotation prescriptions (DNR, county boards).

***Legislative Actions***

7. Propose that $800,000 be appropriated to the DNR and $500,000 to the counties in the next and subsequent bienniums to fully implement continuous inventory programs on a 10-year cycle on state and county lands. Funds should be appropriated to counties based on how many acres of land are administered (DNR, county boards).

8. Propose that $3 million be appropriated in the next and future bienniums for private forest landowner assistance and information programs administered by the Division of Forestry. These funds should be used both to encourage management actions and for cost share expenditures (DNR).

9. Propose that funds be appropriated for the Forest Research Advisory Committee (as mandated in M.S. 89A.08) to analyze ways to price wood fiber and set base prices for sales on all ownerships (Minnesota Forest Resources Council, University of Minnesota).

   *Note: The Task Force did not reach full agreement on the following two proposed actions. Members did agree, however, that these actions should be included in the report.*

10. Propose legislation that would enable DNR and encourage county boards to provide relief for non-secured contracts (DNR, county boards).

11. Propose legislation that would enable DNR and encourage county boards to provide relief for secured contracts (DNR, county boards).

**Maintenance of Working Forestland Base**

***Legislative Actions***

1. Propose that $1.56 million be appropriated for implementation of the Sustainable Forest Resources Act (M.S. 89A) and to eliminate the sunset on the Act (Minnesota Forest Resources Council).

2. Continue to fund the Forest Legacy program (DNR, LCCMR).

3. Propose that $200,000 in one-time funds be appropriated for the Minnesota Forest Resources Council's study and recommendations to maintain the productive forestland base (Minnesota Forest Resources Council).

**Forestland Productivity/Health**

***Legislative Actions***

1. Propose that funds be appropriated to increase forest management and productivity investments on private forestland (DNR).

2. Propose that $2 million be appropriated for the coming biennium to increase forest management and productivity investments (e.g., pre-commercial thinning) on state land (DNR).

**Professional Capacity**

***Legislative Actions***

1. Propose that funds be appropriated to provide non-conventional contract opportunities for loggers to do site preparation on DNR and county lands, and encourage the USDA Forest Service to provide stewardship contract opportunities for loggers to do site preparation on federal lands (DNR, county boards, USDA Forest Service).

2. Direct and fund DNR and encourage county boards and the USDA Forest Service to fill all vacant public forester positions (DNR, county boards, USDA Forest Service).

3. Direct DEED to develop and provide funds for small business training for existing and prospective loggers (DEED).

## Transportation

*Legislative Actions*

1. Support legislation that allows trucks to haul finished forest products (paper, treated and untreated lumber, engineered wood products and barrel staves) with the same weight limits and requirements in current law (MS 169.8261) for raw and unfinished forest products (90,000 lbs. summer, 98,000 lbs. winter; six axles with brakes; MN DOT permit; not applicable on roads and bridges posted for lower weights; not applicable on Interstate Highways, etc.) (MN DOT).

2. Encourage Minnesota's Congressional delegation to support federal legislation to allow Minnesota weight provisions (MS 169.8261), as recommended to be modified in recommendation 1 above, for hauling raw and unfinished and finished forest products to apply on Interstate Highways (Governor).

3. Direct MN DOT to fund improvements in roads and bridges to expand the 10 ton route system and its bridges to facilitate the movement of raw and unfinished and finished forest products from their points of origin or manufacture to their final destination (MN DOT).

4. Encourage Minnesota's Congressional delegation to increase rail competition and decrease costs for shipping forest products and to repeal railroad immunity from federal anti-trust statutes. Work with the National Governors Association and other Governors Associations to promote this legislation. Develop and support state legislation that would support competitive rail service for the forest products industry (Governor, MN DOT).

## Environmental Review and Permitting

*Administrative Actions*

1. Direct the Minnesota Pollution Control Agency (MPCA) to complete the environmental review and permitting benchmarking analysis (Minnesota Session Laws 2005, 1st Special Session, Chapter 1, section 2, subd. 7), and to fully and expeditiously implement its recommendations (MPCA).

2. Direct the MPCA and DNR to expedite environmental review and permitting timelines for forest products industry project proposals (MPCA, DNR).

## Taxation

*Legislative Actions*

1. Propose legislation to convert the current sales tax rebate for forest products industry capital equipment to a sales tax exemption and to broaden sales tax exemptions to include additional logging equipment (DEED).

2. Propose amendments to the Sustainable Forestry Incentives Act (SFIA) to encourage enrollment and foster forest productivity and timber harvesting (DNR, Department of Revenue).

3. Propose legislation to increase the sales weighting for the Corporate Franchise Tax to 100% (DEED, Department of Revenue).

**Research**

*Legislative Actions*

1. Propose that $200,000 in one-time funds to be appropriated for the Forest Resources Research Advisory Committee (as mandated in M.S. 89A.08) to provide direction on research topics recommended by the Task Force (Minnesota Forest Resources Council, University of Minnesota).
    a. Identify and recommend best practices for setting up and administering timber sales on public lands.
    b. Study history of timber market corrections.
    c. Conduct stumpage markets/land management economic analysis.
    d. Conduct research on value-added manufacturing.
    e. Conduct research to support adoption of improved logging technology.

2. Propose that $480,000 be appropriated to fund the Forest Resources Interagency Information Cooperative as mandated in M.S. 89A.09 (University of Minnesota).
    a. Develop common forest inventory formats, growth models for managed forest stands for harvest scheduling, a forest wildlife habitat model synthesis and an information database on Minnesota's family forest ownerships and associated management and trends.
    b. Apply harvest scheduling and associated forest planning methodology to county forest management on a cooperative basis.
    c. Fund an applied research position in forest productivity/silviculture to be housed at Grand Rapids or Cloquet to lead cooperative stand improvement implementation.

**Public Attention/Knowledge**

*Administrative Actions*

1. To increase public understanding about the importance, issues, needs and contributions of the forest products industry, direct and fund the DNR to design a collaborative forest industry public education program that complements existing private and public forest industry and forestry educational programs (DNR).

## Long-Term Recommendations

Because of the need to focus on immediate administrative actions and the limited time available for its deliberations, the Task Force could not fulfill the Governor's charge to develop "long-term recommendations[4] to retain and increase the competitiveness of Minnesota's forest industry." As a result, the Task Force requests that the Governor consider the following additional recommendations:

1. Request the Task Force to reconvene between January and May 2007 so it can identify and make long-term recommendations to address global competitiveness of the primary forest products industry. Make arrangements to provide financial and staff support for the Task Force (Governor).

2. Create a follow-up team to work with the Governor's Office to formulate a comprehensive implementation strategy for near-term and long-term task force recommendations. The team should include high-level decision makers capable of making incisive action recommendations to the Governor and Legislature (Governor).

[4] Long-term recommendations include administrative and legislative actions that should be taken following the end of the 2007 Minnesota legislative session.

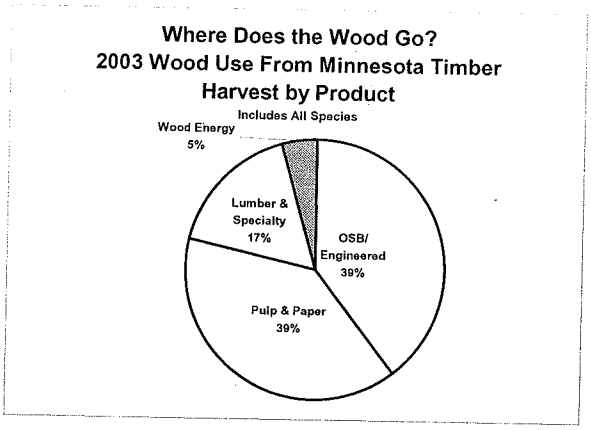
# Appendix 1

## Minnesota's Primary Forest Products Industry: Background, Trends and Outlook

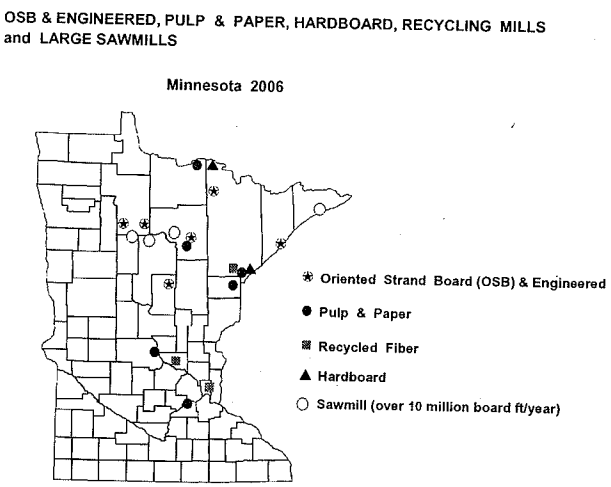
### Minnesota's Forest Products Sectors

In order to reach a common level of understanding of the primary forest products industry in Minnesota, its impacts, and the forces causing it's changing competitive status, it is important to identify the product sectors most relevant to Minnesota and review the most recent developments in each sector. "Primary" industry refers to producers of lumber, engineered wood products[1] and paper that are typically inputs to other value-added industries.

The primary forest products industry has three main sectors, which are often separated according to the products they produce: 1) paper/pulp, 2) engineered wood products and 3) lumber.




**Source:** Wood Use Data From Mill and Fuelwood Surveys conducted by USDA Forest Service, Northern Research Station & DNR. Specialty products include veneer, posts & poles, shavings & landscape chips




### Overall Trends

### Recent Oriented Strand Board (OSB) Mill Shutdowns

Ainsworth Lumber Co. Ltd. permanently shut down one of its production lines at its Bemidji Oriented Strand Board (OSB) mill in late August. The newer, second line in Bemidji continues to operate. In late September, Ainsworth announced that they were suspending OSB production at their Grand Rapids and Cook facilities for an indefinite period. The company announced that production at the Grand Rapids and Cook facilities will only resume when warranted by improved market and cost conditions.

### Global Marketplace

Minnesota's large forest products mills are now owned by very large companies that have mills all over North America, and in some cases, the world. This means that they must now not only compete with other companies in the global marketplace for product sales, but must also compete inside their own companies with other, often newer/more efficient mills for capital reinvestment dollars, in order to modernize. Since these capital reinvestment costs are on the scale of hundreds of millions of dollars, they will tend to flow to areas with attractive economic futures and comparably less risk. The greatest risk to investment in Minnesota is not due to political and economic factors, but instead is caused by rising raw material, logistics, and energy costs, amplified by the recent volatility

[1] *Engineered Wood: Wood products produced by binding together wood strands, particles or fibers with adhesives.*

experienced in these input costs. Without the stabilization of some of these risk factors, companies may look to invest elsewhere, setting the stage for eventual closure of mills in Minnesota.

### Older Technology/Machines in Some Minnesota Mills

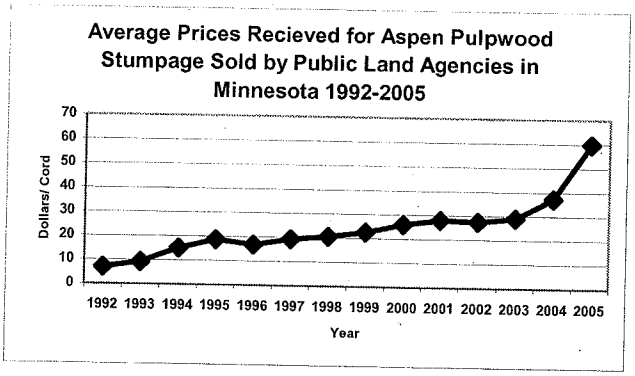
Although there are some very modern mills in Minnesota, some facilities' lines and machines are old by global standards (e.g., the Ainsworth Bemidji line that closed permanently). Older mills tend to be less efficient and more costly to operate than newer mills coming online. Mills with high production costs relative to others in a companies' portfolio are the first to close or be idled when markets turn downward.

### Wood Demand

The permanent line shutdown in Bemidji resulted in a reduction of around 160,000 cords of annual wood demand. Additionally, the mills in Grand Rapids and Cook, together, use around a half-million cords annually. This current reduction in demand, in the context of 4.1 to 4.2 million cords total primary wood industry annual demand in 2005, is a significant issue for the industry, including loggers and truckers, and for forestry in Minnesota. A prolonged reduction in demand of this magnitude would have significant impacts on logging capacity, on the economies of impacted communities and surrounding areas, and on the amount of forest management accomplished on public and private lands.

### Timber Prices

Aspen timber prices reached record levels in 2005, fueled largely by expectations of continuing high wood product commodity prices and tight aspen supplies. Average price for aspen pulpwood on public land timber auctions in 2005 was $59.70, compared to only $28.76 in 2001. The price rise for aspen was probably the largest in the nation over this time period. With the current reduced commodity prices and demand, timber prices are dropping significantly. The most recent DNR timber auction in Aitkin on December 4 resulted in average aspen pulpwood prices of around $26.90/cord.




### Logging Infrastructure

High stumpage prices and a short-term decrease in the demand for wood have also threatened logging infrastructure, which is vital to this industry. Logging businesses, generally small businesses that require large capital investments, have been squeezed as large wood consumers try to hold down prices, making logging less and less profitable. This, combined with an aging workforce, is causing loggers to leave the business, which devastates these small businesses and will further hamper the industry even as conditions improve.

### Pulp and Paper Trends and Outlook

**Background:** Minnesota's paper mills are located here largely due to the available aspen, spruce and balsam fir resources. These species have fiber qualities prized in the manufacture of coated publication papers and other types of paper produced by Minnesota mills. Other factors are proximity to important markets and access to a highly educated work force.

**Trends:** Profitability for printing and writing papers, which is important to Minnesota's mills, has been fair since mid-2003. However, profit margins have been reduced by rising costs for many production inputs, especially wood and energy.

Over the past decade, most capital investment in pulp and paper has been in Europe, China and South America. Minnesota, and other states and provinces in North America, are at a competitive disadvantage in some ways:

-New technologies allow production in places without a highly skilled workforce.
-Lower cost fiber is available elsewhere in the world, especially in highly productive tropical forests.

-Larger-scale and newer operations are opening elsewhere. The new machines are more efficient than older machines operating in Minnesota.
-Environmental review takes longer and is more expensive in Minnesota than in many competing regions.
-Transportation costs are higher in Minnesota than in some competing regions, largely because of truck weight restrictions.

√ **Demand**
Market growth for printing and writing papers has been 4.8% since 2003. Market prices are up 15% over 2003.[2]

√ **Supply**
Some pulp and paper capacity is being lost in North America, especially in Canada, where there are more mills producing newsprint – a market that has softened considerably over the past several years. Some capacity is also being lost in printing and writing papers. Printing and writing paper capacity declined 3% in 2006 vs. 2005 due to mill closures and production curtailments.[2]

√ **Rising Production Costs**
Paper production costs have risen substantially over the past several years, forcing some mills in North America into permanent closures. Minnesota mills have thus far survived, but continue to struggle competitively due mainly to increasing costs. In addition to wood, energy costs have risen substantially. The increase in energy cost not only has direct impact on cost of manufacturing, it also has driven up the cost of other production inputs such as chemicals, additives and other materials used in the papermaking process.

**Outlook:** Growth in printing and writing paper markets is expected to be flat for the next several years.[2] Use of electronic communication and storage continues to have a negative impact on paper markets. Threats to Minnesota mills include global competition from low-cost labor regions such as China and low-cost fiber regions such as South America.

## Engineered Wood Trends and Outlook

**Background:** Minnesota's engineered wood mills are located here largely due to access to a significant aspen resource, the educated work force and proximity to key markets. Their current competitive struggles are largely due to high relative timber raw material costs. There is a simple principle that largely explains why the engineered wood and lumber sectors of the forest products market typically feel more pain from high wood costs than the paper sector: for paper, wood raw material comprises somewhere around 15% of total production costs. For engineered wood products, wood raw material has historically made up roughly 35% to 40% of total production cost.

**Trends:** This sector is largely dependent on housing markets. There was excellent profitability for producers of OSB (Oriented Strand Board) and engineered wood over the past several years, enabled by very robust housing markets in 2004 and 2005, and a lack of new OSB capacity coming online. The situation has changed dramatically since the end of 2005. Reduced demand, increasing supplies, and rising production costs have contributed to a severe reduction in OSB prices and profits in 2006. Price per thousand square feet of OSB from north central mills was $416[3] in late September of 2005. The price in September of 2006 was $165.[3]

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[2] *RISI, North American Graphic Paper Forecast, April, 2006.*

[3] *Dr. Al Schuler, US Forest Service Economist*

√ **Demand:** OSB demand has softened considerably, due primarily to a downturn in new housing construction in the U.S.

√ **Supply:** OSB supplies have recently increased significantly and are poised to increase more in the next year as new mills open and a large amount of new OSB capacity comes "on-line" in the southeastern U.S. and Canada. Between September 2006 and the end of 2008, seven new OSB plants in the southeastern U.S. and Canada are scheduled to start up, with another in the southeastern U.S. doubling its capacity. The new mills being built tend to be larger and more efficient than older mills. Additionally, they are located in regions of North America with access to cheaper wood.

√ **Rising Production Costs**
Costs for the wood, resins, energy and transportation needed to produce OSB and other engineered wood products and get them to market have risen considerably over the past several years. Of these costs, resin, energy and transportation have risen everywhere. Therefore the high price of aspen regionally, and in Minnesota in particular, is the single biggest production cost factor causing the reduced competitiveness of Minnesota mills.

**Outlook**: The outlook is largely dependent on two factors: Housing markets, and added product capacity.

√ **Housing**
Housing markets have softened considerably over the last 8 months. There are significant inventories of unsold houses on the market.

*The consensus housing forecast for 2007 is 1.6 to 1.65 million total starts (Seasonally Adjusted Annual Rate) and 1.3 to 1.35 million single family starts, down about 23% from 2005 levels. Those same analysts expect residential activity to return to trend levels some time in 2008.*[3]

√ **Capacity**
The tremendous amount of new OSB capacity coming online is likely to have a serious dampening effect on OSB prices for the long term. See "Trends" supply analysis above.

## Lumber/Specialty[4] Trends and Outlook

**Background:** Softwood lumber is largely used in structural (construction) applications. Markets were very good during mid-2003 through 2005, but have softened rapidly since then due mainly to reduced housing demand and large volumes of softwood lumber imports from Canada. It is important to note that there is an often-overlooked interdependence between sawmills and pulp mills. Timber sellers and loggers require pulpwood markets for the smaller diameter portion of trees in order to separate out higher-value logs for sawmills. Therefore, lack of markets in the pulpwood-using sector can have a negative impact on supply of softwood logs to sawmills. Another point of interdependence is the reliance of some sawmills on markets from pulp mills for the chip residue they produce.

Hardwood lumber is largely used in "appearance" applications such as cabinets and furniture. Markets vary greatly depending on the species and product in question, but largely follow trends in construction/ remodeling activity. Markets for most species and grades were very good from mid-2003 through 2005, and have softened considerably since then.

Expensive timber can be very painful for the lumber sector, where log costs can account for over 70% of final production cost.

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[4] *Specialty includes shavings mills, poles and log home builders.*

**Trends:** Sawmill capacity in Minnesota continues to shrink. Sawmill production was about 302 million board feet in 2001, falling to 272 million board feet in 2004. Although some sawmills have been profitable, many of Minnesota's sawmills have struggled with profitability in the recent high price wood environment.

**Outlook:** Outlook varies greatly by species and product, but markets for many grades and species of lumber/ specialty are likely to continue to be fairly weak for the next 12 to 18 months, due to the greatly softened housing market. Threats to Minnesota mills include competition from Canada for softwood markets, and global competition in hardwood markets such as furniture from low-cost labor regions such as China. Competition from low-cost timber resource countries such as Russia is a factor in both hardwood and softwood sawmill sectors.

## Forest Landowner Considerations

Any discussion of Minnesota's primary forest products industry should include its intimate connection to the forest itself. Much of northern Minnesota is covered by a highly productive, diverse forested landscape. These forests have been a key driver of a significant forest products industry for decades.

Until fairly recently in the industry's history, supply of many species of trees exceeded industrial demand by a wide margin. As a result, timber prices for most species were relatively low. Ability to manage forests through commercial timber harvesting was also fairly modest. This situation began to change in the 1980s and 1990s, as several engineered wood and pulp and paper mills were built or expanded, and demand increased rapidly. Timber prices and levels of forest management rose significantly. During times of high product demand in this period, forest product manufacturers enjoyed profitability. Forest owners also enjoyed profitability, because timber receipts are a critical piece of revenue generation for them.

As Minnesota looks to strengthen the competitiveness of its primary forest industry, it is important to realize the necessity of maintaining landowner interest in forest management and investment, which will help sustain a flow of timber from private lands over the long term. Actions being considered to address current industry concerns need to be considered in the context of their impacts on the forest and forest landowners, which are the very life-blood of the manufacturing businesses that make up Minnesota's forest products industry.

**For more information on Minnesota forest industry and forest resources, see the annual DNR report "Minnesota's Forest Resources." Available on the web at:**
**http://www.dnr.state.mn.us/forestry/um/index.html**

## Appendix 2

## Summary of recent and proposed administrative actions to address current market conditions

The following summary highlights recent administrative actions taken or proposed by counties, the state, and the federal government to address the current market conditions and mill closings regarding the primary forest products industry. It is organized by agency.

**Counties**

Aitkin

- Deferred the expiration of date for all timber auction sales on the books as of December 1st, 2006 by one year. Will allow the letter of credit option for applicable timber auction sales regardless of when it was purchased.

Becker

- Authorized a six-month free extension to all sales due to expire in 2006.

Beltrami

- Allowed all existing contracts to be cancelled if requested by December 11, 2006 at 4:30 p.m. This is a one-time opportunity with a return of one-third of down payment to the contractor. Contractors will be required to sign a mutual cancellation of contract.
- One-year extensions may be offered by Beltrami Natural Resource Management. Request must be made by December 11, 2006 at 4:30.
- All timber auctions will be conducted using a sealed bid process for one year and then evaluated.
- Base prices for timber sales will be set using 2003 prices.
- The next auction is December 7, with a special auction of forfeited sales in early January.

Carlton

- County Board will likely grant free, one-year extensions for any contract expiring in 2007.
- Auction stumpage rate for aspen was reduced to $22 per cord.

Cass

- No refunds of down payments or sale opening permits will be allowed.
- Operators that forfeit sales will be required to pay 25 percent of bid price for down payment for a period of two years.
- The percentage of sealed bid sales will be increased.
- The use of Lump Sum Contracts (no species pricing) will be expanded.
- No extensions will be granted at this time for market reasons (sales do not expire until March 2007).
- County will offer re-pricing and re-offering on unsold October auction tracts on sealed bid December 28, 2006. All returned sales will be re-valued and offered for auction sale with minimum delay

Clearwater

- In early October 2006, reverted to using 2004 base prices.

- County Board granted free extensions until March 15, 2008 for all sales expiring in December 2006 and April 2007.

Crow Wing

- One-year extension of inactive timber sale contracts expiring in 2006 or 2007 at no charge. Written request for extension must be submitted by February 1, 2007.

Hubbard

- Board approved allowing loggers to forfeit any sale until October 31, 2006 where aspen is the major species, a refund of their 15 percent deposit, and re-offer of those sales at a later auction date.
- Extension was granted to March 15, 2008 at no charge for timber sale contracts that expire in 2006 and 2007 where aspen is the major species.
- Approved using Minnesota DNR stumpage prices in the future.

Itasca

- Authorize the Land Commissioner to have the discretion to grant a one-year extension without charge on existing timber permits as of November 1, 2006 expiring through March 1, 2008 and if a permit holder is granted a one-year extension without charge then forfeits the sale, the regular extension fee of 10 percent of the uncut bid-up balance will be reinstated and charged to the permit holder.
- Existing permits as of November 1, 2006 that are forfeited through May 1, 2007 will result in loss of down payment as per current policy but no further penalty will be assessed.

Koochiching

- Granted a one-year free extension for timber sales expiring on or before May 2008. The current policy of requiring a timber sale installment payment of 20 percent of the total sale value, to grant a first year extension, will be postponed for one year. These changes in policy do not include permits sold on, or after, or already in extension, as of November 2006.
- Those who forfeited tracts will lose their down payments. However, the existing forfeiture policy of an additional 10 percent penalty and non-bid for two auctions is waived for permits forfeited between November 14, 2006 and January 1, 2007. This exclusion only applies to permits purchased before November 2006.

Lake

- Will allow one-time extension of expired timber sales for an additional year without a 25 percent increase (normal policy) in the price of the stumpage. Due to market conditions, sales will not have to be paid in full to be extended, however 15 percent down payments will be forfeited if a timber sale is returned.

Pine

- Modified the extension policy for all sales sold in the year 2004 requiring payment of a single cutting unit instead of payment in full to extend the sale, which is the current policy.

St. Louis

- Grant extensions for contracts on the books on October 1, 2006.

- Sale turnbacks (voluntary) will retain the bid deposit (15 percent of appraised) with no additional cost to purchaser if turned back in 2007 – sales will be returned to market asap for resale (2007 calendar year is the turnback period).
- There will be a base price adjustment to reflect market conditions.

**Minnesota DNR**

- Offered interest free, one-year extensions for timber on existing DNR sales that would have expired by December 31st, 2007.
- Rolled back DNR base stumpage prices to 2002 levels to be more in line with what better reflects today's wood markets. These new base prices are more comparable to today's product and stumpage price index, and will affect both informal and auction sales. DNR Forestry offices are now working quickly to redo appraisals to reflect these new prices. Due to the appraisal changes, auctions listed on the DNR website are being rescheduled to comply with statutory advertising requirements. All auctions previously scheduled for the month of November will be held before December 20, 2006.
- Determined that several fall auctions will be by sealed bid. Agreed to offer more state timber auctions via sealed bid. (Responds to propose action: Investigate using more sealed bids)
- Continued to incorporate new modeling software into Subsection Forest Resource Management Planning (SFRMP) efforts and examine methodology used to estimate and project sustainable timber harvest levels. (Responds to proposed action: Use effective modeling technology – this is also a longer-term action)
- Committed to continue offering its full annual planned harvest level.

**USDA – Forest Service**

- Re-offering no-bid sales from FY 2006.
- Advertised rates have been adjusted downward in response to current market conditions.
- Continuing to monitor sale offerings and market conditions, adjusting advertised rates as appropriate.
- Extending contract term lengths and associated mid-term payment dates by one year for qualifying timber sales.

## Appendix 3

## Base Timber Pricing Summary

| Agency | Base Price Development Procedure |
|---|---|
| Aitkin | Use figures from DNR's Annual Report of Public Stumpage Sales and adjust prices depending on volatility of recent auction results. |
| Becker | Current timber base prices will be reviewed and new prices will be set in January 2007. |
| Beltrami | The base range is calculated as 60% (low end of range) to 75% (high end of range) of the previous years average stumpage rate per species. 2003 prices are now being used due to changes in market conditions. |
| Carlton | For the last 5 years, the county has typically set the base aspen rate between $25 and $30, depending mostly on access and timber quality. For the December 13 auction, the price has been reduced to $22. |
| Cass | Individual land mgrs access Cass County historical database to price comparable sales and use own judgment to adjust figures based on relevant factors such as current market conditions. |
| Clearwater | Base prices are determined by historical transaction data in the region. Some species and products are more easily addressed than others. |
| Cook | No current process; have had no county timber sales for 6-7 years. |
| Crow Wing | Base price is determined using sales information from other agencies e.g. transactional evidence. |
| Hubbard | Uses DNR base prices. |
| Itasca | Uses transactional evidence in and around Itasca County. |
| Koochiching | Transactional evidence from 3-4 quarterly auctions of the prior year is used to determine the base price, which, is then reduced by 30%. This was not done in 2005 due to highly erratic prices on certain tracts. Because of the current situation, the November auction will trigger a reassessment, probably resulting in using one or two quarters from 06 to establish a new 07 base as explained above. |
| Lake | Base price is developed for each sale by using DNR base price list, preceding county timber sale stumpage average and production factors. Market conditions are then factored into base price. |
| Pine | Effective January 1, 2007, the County will use the DNR base price as its guideline. |
| St. Louis | Base price is established by using the average price of scaled wood on contracts sold during the previous five years. Prices are reviewed January of each year; and prices are updated every two years. Auction prices are developed using a bid allowance factor multiplied by a combination of weighted volume, total acres, logging costs and timber quality. |
| USFS | 1. Base values are calculated using volume-weighted average bid prices of competitively sold timber by species and product in (typically) the previous 4 quarters. 2. The Chippewa NF then reduces by 25% for red and white pine saw timber and by 35% for all other species. The Superior NF is currently using a 35% reduction for all species. |
| DNR | Base prices for informal sales are calculated by using the volume weighted average auction selling price for each species and product during the preceding 12 months, exclusive of salvage wood and extremely high bids. A bid allowance factor is applied to the base informal prices to derive the base auction prices. |

Note: Agencies derive actual sale appraised prices by adjusting their base prices for factors such as access, terrain, timber quality and density, sale size, distance to mill and/or current market conditions.

Source: Report based on responses from selected land management agencies. Lillian Baker, DNR Forestry, Timber Sales Program Supervisor. November 6, 2006.

# Appendix 4 Potential Legislative and Administrative Actions

## LEGISLATIVE Actions At-A-Glance

| Key Issues | A. Potentially viable actions for the 2007 session of the Minnesota Legislature | B. Actions that would take a significant amount of time and effort to move forward | C. Actions that could face significant challenges and/or opposition. |
|---|---|---|---|
| **A. Wood and Fiber Availability and Price** | **Appropriations**<br>• Accelerate and fund both one-time catch up and ongoing inventory needs on state and county lands – General Fund, LCCMR (1)<br>**Policy**<br>• Provide incentives to harvest wood in first year of contracts – state policy (2) | | • Eliminate the start price and use the market to set prices for timber sales (30)<br>• Eliminate regular auctions. Conduct them as needed to maximize availability of timber. (31)<br>• Correct the price (32)<br>• Deal with high price permits at a later day 33)<br>• Reform federal NEPA making it more difficult to block timber sales (34)<br>• Streamline public forestry processes (35) |
| **B. Maintenance of working forestland base** | **Appropriations**<br>• Increase forest management investments (e.g. pre-commercial thinning) – for state lands this would most likely be a General Fund appropriation (3)<br>• Fund and Extend the "sunset" on the Sustainable Forest Resources Act (MN Forest Resources Council) – General Fund (4)<br>• Continue to fund Forest Legacy – most likely through the LCCMR (5)<br>• Fund the MFRC's proposal for maintaining the productive forest land base – General Fund (6) | | • Turn over management of public lands to private entities (36) |
| **C. Forestland productivity/health** | | | |
| **D. Professional capacity (Loggers, resource managers)** | **Policy**<br>• Modify DEED statutes relating to business subsidy agreements to provide greater flexibility for grants for job retention (7)<br>**Appropriations**<br>• Provide advice to family forest landowners through the American Tree Farm or Forest Stewardship programs – this would most likely be General Fund or LCCMR appropriations (8)<br>• Increase private landowner assistance and access to information – General Fund, LCCMR (9)<br>• All vacant public forester positions should be filled – General Fund for DNR (10) | • Provide extended unemployment benefits to laid off workers (22)<br>• Provide relief for high price non-bonded contracts (23)<br>• If closures continue, loggers return sales and receive down payments (24) | • Provide relief from high price bonded contracts (37)<br>• Provide financial assistance and safety net for loggers (38) |
| **E. Transportation (truck weights and captive rail)** | **Policy**<br>• Support federal captive rail legislation, and explore state legislative options to address captive rail issues – federal and state policy (11)<br>• Increase allowable truck weights for outbound finished products – state policy (12)<br>• Increase allowable truck weights for inbound and outbound products – federal policy (13)<br>• Increase allowable truck weights to 98,000 lbs year round for six axle vehicles; state and federal policy(14) | | |

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| | **Appropriations**<br>• Upgrade substandard roads and bridges (including forest roads) – funding and policy (15) | | |
| **F. Permitting and Environ review** | | | |
| **G. Taxation** | **Tax**<br>• Convert sales tax rebate for capital equipment to an upfront exemption – state policy (16)<br>• Accelerate implementation of the 100% sales weighting for the corporate franchise tax – state policy (17)<br>• Include additional logging specific equipment (e.g. skidder tires) in the definition of items exempt from sales tax – state policy (18)<br>• Improve sales tax treatment of logging equipment – state policy (19)<br>• Develop additional incentives to keep industry viable (20) | • Introduce SFIA amendments to enact taxation-related directions for maintaining forestlands e.g. scrap whole program and consider alternatives (25)<br>• Make adjustments to property tax law (in response to SFIA study)(26)<br>• Revise SFIA to encourage harvesting (27)<br>• Utilize conservation easements and tax policy (2008 bonding bill)(28) | |
| **H. Energy** | | • Provide grants or loans to acquire biomass harvesting equipment (29) | • Encourage sensible energy policy (39)<br>• Provide incentives to make forest industry more energy self-sufficient (40) |
| **I. Research** | **Other**<br>• Research – the subcommittee recommends that the MFRC Research Advisory Committee be convened to provide direction on the issues submitted – General Fund (21) | | |

## ADMINISTRATIVE Actions At-A-Glance

| Key Issues | A. Potentially viable near-term actions | B. Actions that would take a significant amount of time and effort to move forward | C. Actions that could face significant challenges and/or opposition |
|---|---|---|---|
| **A. Wood and Fiber Availability and Price** | **Counties**<br>• A number of counties are considering a range of options, including granting extensions, allowing forfeitures that result only in the loss of the down payment, and some price reductions. Any option proposed by a county will require the approval of the county board, which should occur in late November.(41)<br>• Counties should grant 1-year extension (42)<br>• Set base prices to 2003 vs. 2004 levels (some counties) (43)<br>• Use public/private land exchanges/sales (44)<br>• Continue with certification audits (counties with certified land) (45)<br><br>**DNR**<br>• Maintain timber sale programs and resell unsold timber until it is gone (DNR) (46)<br><br>**DNR, USDA Forest Service** | **Counties**<br>• Revamp pricing mechanisms (59)<br>• Set base prices to 2003 vs. 2004 levels (some counties are considering base price reductions) (60)<br>• Redesign base rate method to respond quickly to significant changes in the market (61)<br><br>**DNR**<br>• Focus on amounts, not method of sale (62)<br>• Use more intermediate sales and less regular auctions (63)<br>• Consider on-line electronic bidding (64)<br>• State should sell timber more evenly throughout the year<br>• Increase frequency of sales using both sales methods (sealed bids and oral auctions) (65)<br>• Increase process efficiency, price and value to benefit all owners and other stakeholders in the short term (66)<br>• Use public/private land exchanges/sales (67)<br>• Use effective modeling technology (68) | **Counties**<br>• Counties should grant 1-year extension (some counties) (88)<br>• Cut more wood at younger age class/rotation age (89)<br><br>**DNR**<br>• Make sales more efficient (sell as-is, no cruising) (90)<br>• State should change its recommended rotation age (91)<br>• Change DNR prescriptions for Extended Rotation Forests (92)<br>• Cut more wood at younger age class/rotation age(93)<br>• DNR should prioritize timber management work over out-of-state fire fighting (94)<br>• Trade landlocked State trust fund land with USFS |

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| | • Each agency needs to set up its targets, stick to them and keep up sales (47)<br>• Maintain timber sale programs and resell unsold timber until it is gone (48)<br>• Sell wood at reasonable price (49)<br><br>**USDA Forest Service**<br>• USFS should sell last year's planned sales and this year's planned sales (50)<br>• Maintain a steady timber program increasing towards Forest Plan Allowable Sale Quantity as budgets permit: FY 07 targets for the two MN National forests have been established and both Forests intend to meet their targets for FY 07:<br>  ○ Chippewa 36 MMBF<br>  ○ Superior 65 MMBF<br>(Forest Service response to "Each agency needs to set up its targets, stick to them and keep up sales") (51)<br>• Continue to grow the National Forest timber program as budgets allow, including strengthening of the timber pipeline (52)<br>• Offer Stewardship Contract sales that include commercial timber, which include activities that reduce the direct cost of the timber (53)<br>• Initiate training on Stewardship Contracting (54)<br>• Continue to offer biomass material for removal (55)<br>• Maintain timber sale programs and resell unsold timber until it is gone (56)<br>• USFS should sell last year's planned sales and this year's planned sales (57)<br>• Keep issues in front of the public (58) | • Prioritize production areas (69)<br>• Develop a transparent process to set sustainable harvest levels (70)<br>• Manage public forests to balance age classes (71)<br><br>**USDA Forest Service**<br>• Utilize permitting/contracting processes in ways that optimize timber availability (72)<br>• Use public/private land exchanges/sales (73)<br>• Help loggers retool for site preparation (74)<br>• Increase process efficiency, price and value to benefit all owners and other stakeholders in the short term (75)<br>• Help FS obtain sufficient funding for on-the-ground work (76)<br><br>**Counties, DNR, USDA Forest Service**<br>• Explore ways to utilize the sale of different species (77)<br>• Review timber utilization standards (78)<br><br>**Counties, DNR**<br>• Put more wood on the market (younger age classes) (79)<br>• Compare sales methods, assess differences and adjust their use as needed to increase availability (80)<br>• Utilize permitting/contracting processes in ways that optimize timber availability (81)<br>• Create access to areas where access does not exist (82)<br><br>**University of Minnesota**<br>• Analyze base prices for sales and all ownerships (83)<br>• Study ways to price wood fiber (84)<br>• Study history of timber market corrections (85)<br>• Identify/recommend best practices for putting up wood (86)<br>• Conduct stumpage markets/land mgmt economic analysis (87) | (95)<br>• Establish harvest plan of 1 million cords/year on state lands (96)<br>• Sell timber on an area basis, not an appraisal basis (97)<br>• Promote intensive management (98)<br><br>**USDA Forest Service**<br>• Put more wood on the market (younger age classes) (99)<br>• Eliminate the base price and use the market to set prices (100)<br>• Set base prices to 2003 vs. 2004 levels (101)<br>• Trade landlocked State trust fund land with USFS (102)<br>• Use public/private land exchanges/sales (103)<br>• Accelerate harvest levels for mature timber (104)<br>• Cut more wood at younger age class/rotation age (105)<br>• Create access to areas where access does not exist (106)<br><br>**MFRC**<br>• MFRC should coordinate between ownerships to increase harvesting (107)<br><br>**Counties, DNR, USDA Forest Service**<br>• Eliminate the base price and use the market to set prices (108)<br><br>**Counties, DNR**<br>• Eliminate regular auctions. Conduct them as needed to maximize availability of timber (109)<br>• Accelerate harvest levels for mature timber (110)<br><br>**More Counties**<br>• Set base prices to 2003 vs. 2004 levels (111) |
| **B. Maintenance of working forestland base** | **DNR**<br>• Support MFRP productivity conference, March 2007 (112) | **MFRC**<br>• Encourage long-term policy development (MFRC) (120)<br><br>**University of MN**<br>• (Study and recommend how to) produce stable wood supply (121) | **DEED, MPCA** (?), **Dept of Commerce** (?)<br>• Promote environmental targets, not mandates) (135) |
| **C. Forestland productivity and health** | | **DNR**<br>• Increase level of interest in private forest management (122) | |
| **D. Professional capacity**<br>• **Loggers**<br>• **Resource managers** | **Counties**<br>• Help loggers retool for site preparation (113)<br><br>**IRR**<br>• Conduct a survey of loggers and truckers to weigh interest in a low interest loan program designed to financially help sustain loggers and truckers during the current industry slowdown. (Iron Range Resources forest industry assistance | **DNR, USDA Forest Service**<br>• Help loggers retool for site preparation (123)<br><br>**DNR**<br>• Increase forestry employment (124)<br>• Aggressive hiring and training (125)<br>• Assure adequate numbers of foresters (126) | **DEED, Dept. of Health** (?)<br>• Deal with high cost of healthcare (136) |

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| | program approval). (114)<br><br>**DEED**<br>• DEED Minnesota Investment Fund (MIF) program for job retention to plants and infrastructure now!(115) | • Maintain/increase continuing education (with U of M, MLEP) (127)<br><br>**USDA Forest Service**<br>• Help USFS obtain sufficient funding for on-the-ground work (128)<br><br>**All agencies/organizations**<br>• Increase process efficiency, price and value to benefit all owners and other stakeholders in the short term (129)<br><br>**University of Minnesota**<br>• Look at all the players and processes in the system to enhance the capacity of the whole system – the "big we" (130) | |
| **E. Transportation (truck weights and captive rail)** | | | |
| **F. Permitting/ Environ-mental review** | **DNR**<br>• Continue with certification audits (116)<br><br>**DNR, MPCA, EQB**<br>• Update on studies and actions taken by MPCA and EQB (117)<br>• Engage MPCA in addressing permitting timelines and obstacles (118) | | |
| **G. Taxation** | | | |
| **H. Research** | | **DNR**<br>• Investigate value-added manufacturing (131) | |
| **I. Energy** | | **DNR**<br>• Ensure adequacy/viability of biomass (132) | |
| **J. Public attention/knowledge** | **Counties, DNR IRR, USDA Forest Service**<br>• Keep issues in front of the public (119) | **DNR**<br>• DNR take lead role in promoting forestry in MN (133)<br>• Intensify coalition building, advertising and other outreach to build understanding about the cost of not managing state's timber (134) | |

## Appendix 5

## List of Task Force Working Group Members

Dave Epperly, Department of Natural Resources, Division of Forestry, Co-chair
Dave Zumeta, Minnesota Forest Resources Council, Co-chair

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Lillian Baker, Department of Natural Resources, Division of Forestry
Patti Blom, Department of Natural Resources, Commissioner's Office
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