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## Minnesota Department of Natural Resources

500 Lafayette Road · Saint Paul, Minnesota · 55155-4037

Office of the Commissioner

651-259-5555



April 13, 2009

The Honorable Ellen Anderson  
Env., Energy and N.R. Budget Division Chair  
75 Rev. Dr. Mr. Luther King Jr. Blvd.  
Capital Building, Room 120  
St. Paul, Minnesota 55155-1606

The Honorable Jean Wagenius  
Environment and N.R. Finance chair  
449 State Office Building  
100 Rev. Dr. Martin Luther King Jr. Blvd.  
St. Paul, Minnesota 55155

Dear Senator Anderson and Representative Wagenius;

According to Minnesota Session Laws Chapter 368, Article 1, section 19, the Commissioner of the Department of Natural Resources (DNR) must provide quarterly forest management investment account (FMIA) fund statements, including a report on the methodology used in calculating the revenue forecasts.

Attached for your review are three documents:

1. A summary report outlining revenue forecast trends and methods, and
2. Timber Sales Revenue Forecast, and
3. The Forest Management Investment Account planning statement

Additional detail is available upon request.

Sincerely,

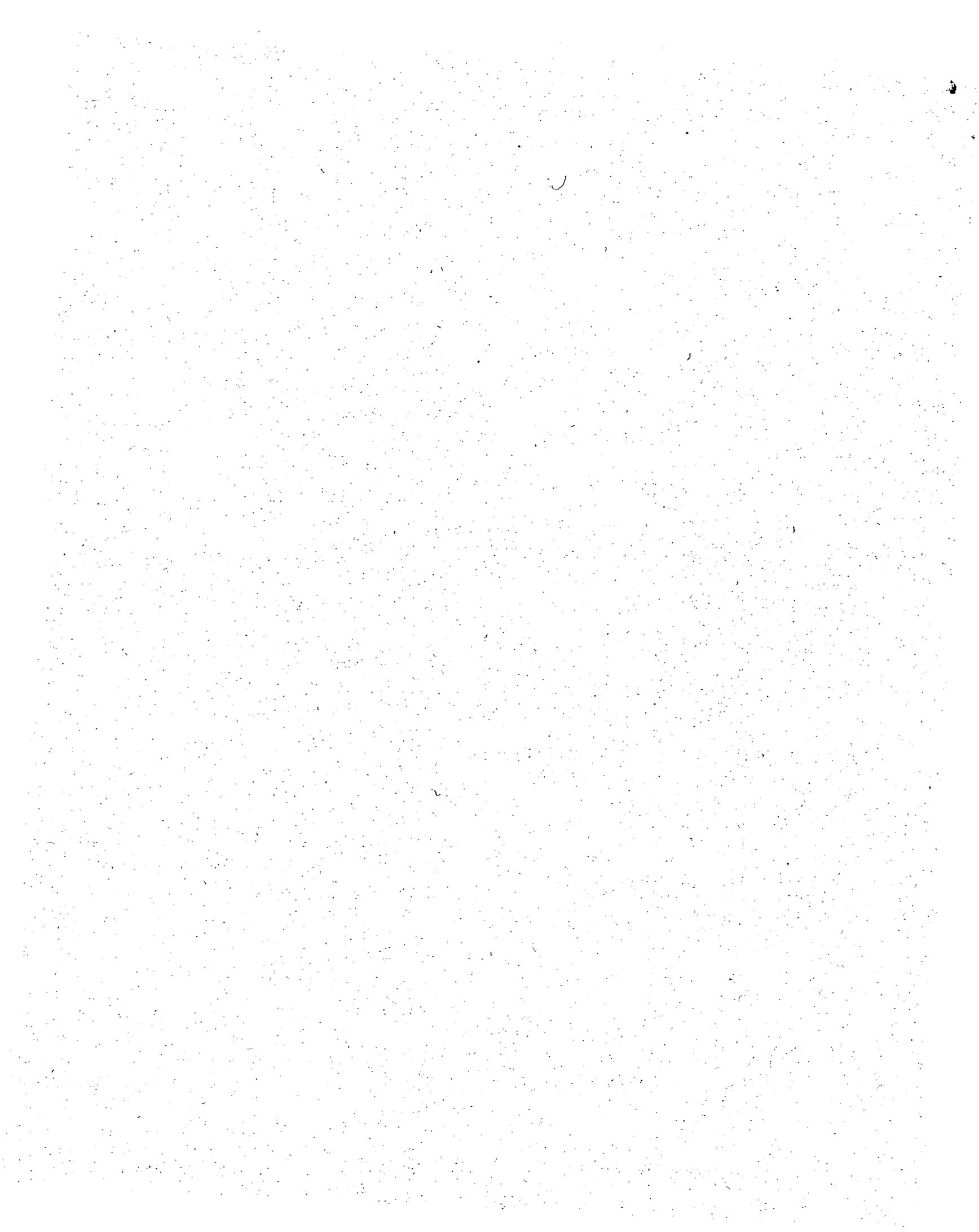
A handwritten signature in cursive script that reads "Laurie Martinson".

Laurie Martinson,  
Deputy Commissioner

Enclosures

Cc: Bob Meier, Assistant Commissioner for Legislative Affairs  
Denise Anderson, Chief Financial Officer, OMB  
Dave Epperly, Director, Forestry  
Mike Salzwedel, Executive Budget Officer, MMB





DATE: 04/06/09

**LEGISLATIVE REPORT – Cost of Preparation**

NAME OF LEGISLATIVE REPORT – Forest Management Investment Account Forecast

Based on:

Minnesota Statute Reference: Minnesota Session Law Chapter 368, Section 19

Prepared by: André Prah, Department of Natural Resources

Phone: 651-259-5548

E-Mail: Andre.Prah@dnr.state.mn.us

Description of Cost	Further explanation if necessary	Amount
Staff Time	1 weeks staff time (multiple staff)	\$2,000
Duplication Cost (includes paper)	Negligible, most work done electronically	
Other:		
<b>TOTAL TO PREPARE REPORT</b>		
<i>(Note: Right click on amount cell and choose update to complete)</i>		\$2,000



# Minnesota Department of Natural Resources

500 Lafayette Road • St. Paul, MN • 55155-40



## April 2009 Timber Revenue Forecast Update

### Background

The Division of Forestry manages 4.2 million acres of State owned forest land, provides forest management and cost share assistance to 140,000 family forest owners holding 5.7 million acres, and protects 45.5 million acres from wildfire. Confronted with declining timber revenue prospects, the Division implemented a fiscal strategy in early FY08 that successfully managed down \$5.4 million in FMIA expenditures to date. Cost cutting was accomplished by holding positions vacant and reduced efforts in: forest improvement, forest roads, ecological classification, forest re-inventory, private land management, and other programs.

### Forecast Summary

In preparing the April 2009 forecast update, we found ourselves in a position of extreme uncertainty with the economy and financial markets in turmoil and the reality of the "great" recession. To date, the federal government has spent \$2.5 trillion to rescue the financial system and approved an additional \$789 billion recovery package including \$507 billion in spending programs and \$282 billion in tax relief. As compared to the January 2009 timber revenue forecast, recession driven impacts to the April 2009 forecast were: (i) lower than expected winter harvest volume, (ii) lower than expected removals average per-unit price, and (iii) a high rate of no-bid sales.

The April 2009 forecast MED was reduced by \$2 million or 9.1% to \$19.5 million as compared to the January 2009 timber revenue forecast MED of \$21.5 million. In addition, FY10 and FY11 forecast MED revenues were reduced by \$1.5 million (7.5%) and \$1.3 million (6.4%) respectively (Table 1).

Table 1. April 2009 Forecast Timber Sales Revenue Summary Table

Scenario	FY09	FY10	FY11
Apr09 MED	\$19,550,000	\$18,496,875	\$18,944,000
Jan09 MED	\$21,510,500	\$19,995,200	\$20,243,950
Change (%)	(9.1%)	(7.5%)	(6.4%)

### Key Changes Since the January 2009 Forecast

- Emergency extensions for timber permits expiring December 1, 2008 through December 31, 2009 in combination with reduced mill operating rates had a negative impact on third-quarter harvest volume. FY09 forecast removals (harvest) volume was reduced from 762,000 to 700,000 cords (not including biomass) based primarily on third-quarter removals of 325,000 cords (preliminary) as compared to 445,000 cords in third-quarter FY08. FY10 and FY11 forecast removals were decreased from 762,000 cords to 742,000 cords to account for increased market risk and uncertainty.
- The Jan09 forecast removals average per-unit price was reduced from \$24.25 per cord to \$23 per cord reflecting a significant operational shift to harvesting, almost exclusively, the most recently sold lowest priced permits as opposed to blending a mix of older higher priced permits. Following suit, the permit default risk adjustment was increased by writing off all existing aspen permits  $\geq$  \$40 per cord, representing approximately 10 percent of volume under contract. The write off reduced the average per-unit price of volume under contract to \$22.50 per cord. In addition, the risk adjusted FY10 forecast removals average per-unit price was reduced from \$23.50 per cord to \$22.50 per cord and the FY11 forecast removals price was reduced from \$23.50 per cord to \$23 per cord.
- As of March 23rd, year-to-date DNR timber sell rate was 87 percent of volume offered, up from 80 percent at the end of last quarter but, still down 6 percent from last year's 93 percent sell rate. The sell rate is expected to finish the year at approximately 92 percent on 900,000 cords offered as timber appraisals and stumpage prices paid continue to adjust to current market conditions.
- Fund allocations were modified to reflect FY09 year-to-date revenue distribution by land class. Acquired Forestry was increased from 20% to 22% and Con-Con was decreased from 25% to 23%.
- The FY09 one-time invoicing gain estimate was increased from \$1.5 million to \$2 million to account for a third-quarter policy decision to finalize winter removals invoicing by the end of April.



### Forecast Methods

The timber sales revenue forecast is a combination of four distinct forecast variables. An additional step is then required to estimate the portion of timber revenue allocated to the Division of Forestry budget. Approximately 50% of timber sales revenue is eventually available for Division budgeting while the other 50% is distributed to various accounts and entities including the School / University Trust accounts, General Fund, and Minnesota counties. Each component of the revenue forecast has its own unique set of metrics, range of variation, drivers, constraints, and inherent uncertainties. The four forecast variables and metrics are:

1. sales volume (volume offer "target" minus an estimate of no-bid sales),
2. sales average per-unit price (regression model utilizing historic stumpage and product price data),
3. removals volume (most recent 5-year adjusted for forecast sales and operational constraints), and
4. removals average per-unit price, (value of timber under contract by fiscal year expiration adjusted for current fiscal year sales price expectations and default risk).

#### 1. Forecast Sales Volume

Through FY09 third quarter, the Division of Forestry sell rate was 87% as compared to 80% through second-quarter and 93% last fiscal year. The April 2009 forecast timber offer volume was reduced from 950,000 cords to 900,000 cords. The forecast sales volume was reduced accordingly to 828,000 cords or a 92 percent sell rate for the year.

#### 2. Forecast Sales Average Per-Unit Price

FY09 YTD all-species average cordwood price was \$20.73 per cord on 441,206 cords sold as compared to the Jan09 forecast value of \$21.50 per cord for the fiscal year average. Selling prices are expected to remain flat through the remainder of FY09 and slowly increase over FY10 and FY11 as housing market conditions start to improve. Forecast sales average per-unit prices were adjusted as follows: FY09, from \$21.50 to \$21 per cord, FY10, from \$22.50 to \$22 per cord, and FY11, from \$23.50 to \$23 per cord.

#### 3. Forecast Removals Volume

Emergency extensions for timber permits expiring December 1, 2008 through December 31, 2009 in combination with reduced mill operating rates had a negative impact on third-quarter removals. FY09 forecast removals volume was decreased from 762,000 cords to 700,500 cords including sawtimber. FY10 and FY11 forecast removals were decreased from 762,000 cords to 742,000 cords to account for increased market risk and uncertainty.

#### 4. Forecast Removals Average Per-Unit Price

Forecast removals average per-unit prices were adjusted downward as follows: FY09, from \$24.25 to \$23 per cord, FY10, from \$23.50 to \$22.50 per cord, and FY11, from \$23.50 to \$23 per cord. DNR is holding 1.1 million cords of aspen under contract with approximately 200,000 cords at book value  $\geq$  \$40 per cord (21% of aspen under contract). Unsecured permit defaults do not generate new revenue for DNR because the forfeited down payment amount is accounted for at the time of purchase. Fiscal effects are to reduce revenue projections as the average per-unit value of volume under contract decreases and to increase program costs through sale reappraisal and re-offer.

### Funds Allocation

Acquired Forestry and Con-Con dollars are allocated on a revenue basis while School/University Trust dollars are allocated on a cost basis. The current land class distribution of timber inventory by book value is similar to historical averages. However, annual removals may deviate from historical averages by as much as  $\pm$ 5% by fund. Hence, annual adjustments are necessary to compensate. FY09 fund allocations were modified to reflect year-to-date revenue distribution by land acquisition status. Acquired Forestry was increased from 20% to 22% and Con-Con was decreased from 25% to 23%.

#### Example Apr09 MED Revenue Forecast (\$19,550,000) Funds Allocation.

Account	Allocation Factor <sup>a</sup>	Allocation	FMIA Portion	FMIA Receipts and Transfers
Acquired Forestry	0.22	\$4,301,000	100%	\$4,301,000
Con-Con	0.23	\$4,496,000	50%	\$2,248,000
School / Univ. Trust <sup>b</sup>	---	certified cost	cost	certified cost

<sup>a</sup>Allocation factors based on book value of current timber inventory and historic averages by land classification adjusted for current fiscal year variances.

<sup>b</sup>FY09 School / Univ. Trust certified costs transferred to the FY10 FMIA account balance. Actual values are subject to significant year-to-year variability.

Contact: Don Deckard, Forest Economist, <mailto:donald.deckard@dnr.state.mn.us>, phone: (651) 259-5287.

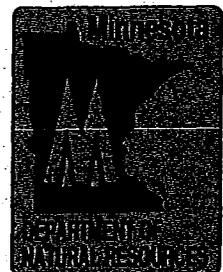
**April 2009**

**Timber Sales Revenue Forecast**

**For lands administered by the Division of Forestry and Section of Wildlife**

***Fiscal Year 2009 - Third Quarter***

Prepared by  
Don Deckard  
State Forest Economist  
DNR – Division of Forestry



### Background

The quarterly timber sales revenue forecast provides critical budget planning information for the Division of Forestry. As required by State law, [see 2008 Laws, Chapter 368, Article 1, Section 19], forecast updates are completed to provide current revenue estimates based on new information and changing expectations. We strive to produce the most accurate and objective forecast possible within the limitations of available information and resources. However, actual timber revenues are determined by a combination of external market forces, physical site conditions, and DNR timber sale policies.

The Division of Forestry manages 4.2 million acres of State owned forest land, provides forest management and cost share assistance to 140,000 family forest owners holding 5.7 million acres, and protects 45.5 million acres from wildfire. Confronted with declining timber revenue prospects, the Division implemented a fiscal strategy in early FY08 that successfully managed down \$5.4 million in FMA expenditures to date. Cost cutting was accomplished by holding positions vacant and reduced efforts in: forest improvement, forest roads, ecological classification, forest re-inventory, private land management, and other programs.

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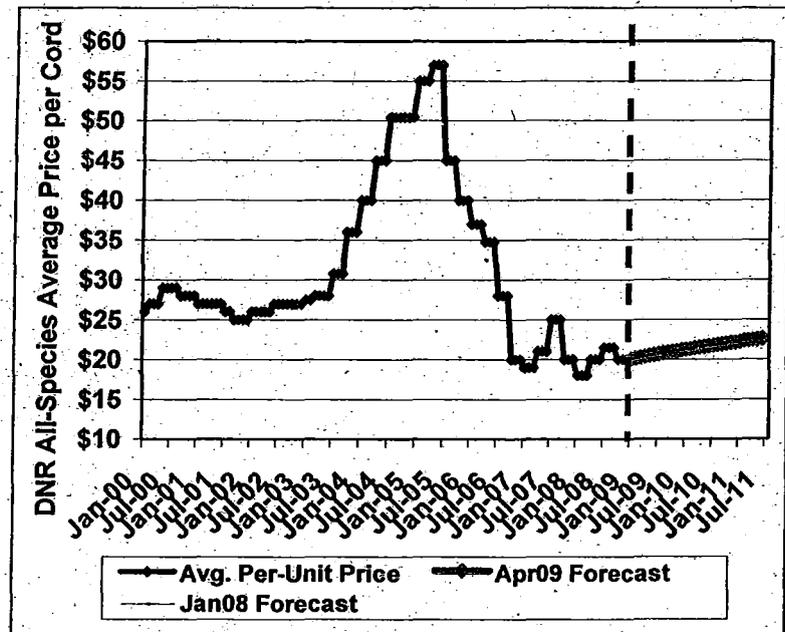
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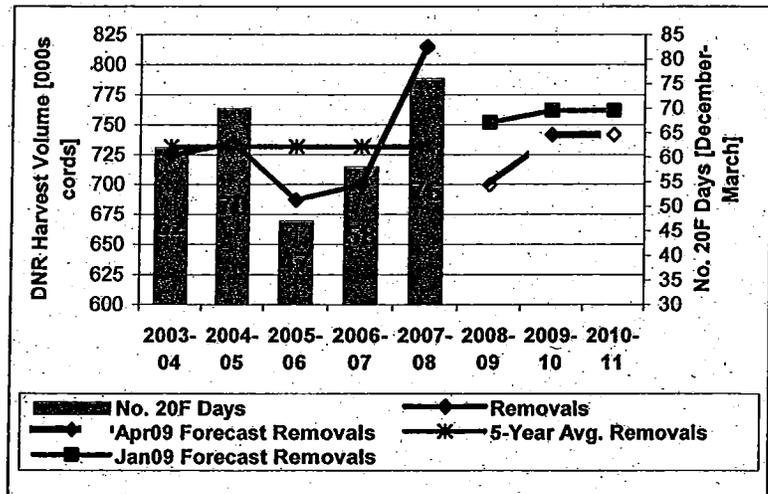
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### 3. Forecast Removals Volume

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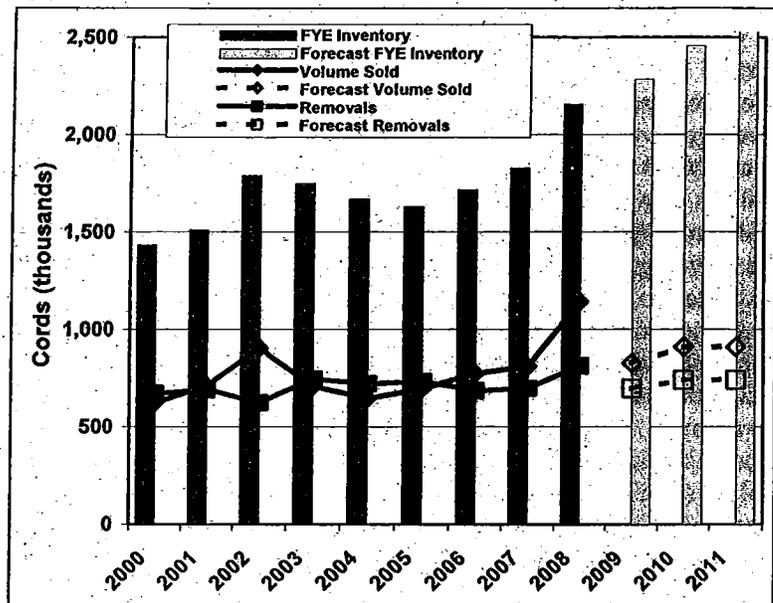
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### Timber Inventory

Volume under contract remains a concern as it plays an important role in the revenue forecasting process and provides insights for the future policy direction of the DNR timber program. At the close of FY08, uncut timber inventory was ~2.16 million cords. This was equivalent to a 2.9-year supply at an annual removals volume of 742,000 cords. Using current forecast sales and removals volumes, timber inventory is expected to reach 2.6 million cords by the end of FY11.

Perpetually increasing timber inventory is not a normal expectation and is not sustainable. The phenomenon seems to be tied to the large volume of winter only operable volume, and for FY09-10 to industrial wood consumption. This topic requires further analysis to better understand long-run timber removals and revenue implications.



### Funds Allocation

Acquired Forestry and Con-Con dollars are allocated on a revenue basis while School/University Trust dollars are allocated on a cost basis. The current land class distribution of timber inventory by book value is similar to historical averages. However, annual removals may deviate from historical averages by as much as  $\pm 5\%$  by fund. Hence, annual adjustments are necessary to compensate. FY09 fund allocations were modified to reflect year-to-date revenue distribution by land acquisition status. Acquired Forestry was increased from 20% to 22% and Con-Con was decreased from 25% to 23%.

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<sup>a</sup>Allocation factors based on book value of current timber inventory and historic averages by land classification adjusted for current year variances.

<sup>b</sup>FY09 School / Univ. Trust certified costs transferred to the FY10 FMIA account balance. Actual values are subject to significant year-to-year variability.

### Forecast Tables

#### FY 2009 Timber Sales and Removals Volume and Value by Quarter.

TIMBER SOLD						
QTR	VOL CDS	VALUE CDS	AVG\$/CD	VOL MBF	VALUE MBF	AVG\$/MBF
FY09Q1 (actual)	111357	\$2,405,973	\$21.61	962	\$176,392	\$183.36
FY09Q2 (actual)	284993	\$6,028,307	\$21.15	1004	\$188,465	\$187.71
FY09Q3 (est. 3/25)	44857	\$710,629	\$15.84	64	\$5,645	\$88.20
FY09Q4 (forecast)	378793	\$8,144,050	\$21.50	1500	\$247,500	\$165.00
<b>SUM/wAVG</b>	<b>820000</b>	<b>\$17,288,959</b>	<b>\$21.08</b>	<b>3530</b>	<b>\$618,002</b>	<b>\$175.07</b>

TIMBER SCALED (REMOVALS)						
QTR	VOL CDS	VALUE CDS	AVG\$/CD	VOL MBF	VALUE MBF	AVG\$/MBF
FY09Q1 (actual)	158109	\$4,139,345	\$26.18	719	\$106,782	\$148.51
FY09Q2 (actual)	144604	\$3,684,338	\$25.48	1649	\$344,155	\$208.71
FY09Q3 (est. 3/30)	325000	\$6,500,000	\$20.00	1320	\$299,052	\$226.55
FY09Q4 (forecast)	65000	\$1,430,000	\$22.00	700	\$122,500	\$175.00
<b>SUM/wAVG</b>	<b>692713</b>	<b>\$15,753,683</b>	<b>\$22.74</b>	<b>4388</b>	<b>\$872,489</b>	<b>\$198.84</b>

#### Notes:

1. Removals volume does not include biomass. Year-to-date, there was an additional 35,000 cord equivalents of biomass volume scaled including the St. Croix State Park timber sale with 11,000 cords. Including biomass, the April09 forecast removals MED = 735,000 cords. Biomass revenues were/are included in the SOLD / REMOVALS OTHER categories.
2. The fourth-quarter removals (volume scaled) forecast MED = 65,000 cords was adjusted downward from the historical average to compensate for accelerated scale entry in March and the expected invoicing gain as compared to last year.
3. Considering we are now into the fourth quarter, estimated probability at  $\pm 5\%$  of MED is at 60% confidence level and the estimated probability of being within  $\pm 10\%$  of MED is at 80% confidence level.

**Timber Sales Revenue Forecast by Fiscal Year, FY 2009 -11.**

FY2009 FORECAST TIMBER SALES REVENUE				APR09 Forecast	
	VOL CDS	TR	PORTION TR		
SOLD CORDS*	820000	\$17,220,000	\$2,583,000		
SOLD SAWTIMBER	7000	\$630,000	\$94,500		
SOLD OTHER		\$575,000	\$86,250		ITC INV INC
REMOVALS CORDS	692000	\$15,916,000	\$13,528,600		+ TS I&P =
REMOVALS SAWTIMBER	8500	\$850,000	\$722,500		\$110,000
REMOVALS OTHER		\$500,000	\$425,000	FY2009	REVENUE w/INT INC
BILLING GAIN		\$2,000,000	\$2,000,000	LOW (-10%)	\$17,495,865
SUM			\$19,439,850	MED	\$19,439,850
				HIGH (+10%)	\$21,383,835
					\$21,493,835

\*Estimate based on 900,000 cords offered with a 92% sell rate; does not include biomass.

FY2010 FORECAST TIMBER SALES REVENUE				APR09 Forecast	
	VOL CDS	TR	PORTION TR		
SOLD CORDS*	902500	\$19,855,000	\$2,978,250		
SOLD SAWTIMBER	9000	\$900,000	\$135,000		ITC INV INC
SOLD OTHER		\$500,000	\$75,000		+ TS I&P =
REMOVALS CORDS	733000	\$16,492,500	\$14,018,625		\$100,000
REMOVALS SAWTIMBER	9000	\$900,000	\$765,000	FY2010	REVENUE w/INT INC
REMOVALS OTHER		\$500,000	\$425,000	LOW (-10%)	\$16,557,188
SUM			\$18,396,875	MED	\$18,396,875
				HIGH (+10%)	\$20,236,563
					\$20,336,563

\*Volume sold estimate based on 950,000 cords offered with a 95% sell rate; does not include biomass.

FY2011 FORECAST TIMBER SALES REVENUE				APR09 Forecast	
	VOL CDS	TR	PORTION TR		
SOLD CORDS*	902500	\$20,757,500	\$3,113,625		
SOLD SAWTIMBER	9000	\$900,000	\$135,000		ITC INV INC
SOLD OTHER		\$500,000	\$75,000		+ TS I&P =
REMOVALS CORDS	733000	\$16,859,000	\$14,330,150		\$100,000
REMOVALS SAWTIMBER	9000	\$900,000	\$765,000	FY2011	REVENUE w/INT INC
REMOVALS OTHER		\$500,000	\$425,000	LOW (-10%)	\$16,959,398
SUM			\$18,843,775	MED	\$18,843,775
				HIGH (+10%)	\$20,728,153
					\$20,828,153

\*Volume sold estimate based on 950,000 cords offered with a 95% sell rate; does not include biomass.

**FORECAST PARAMETERS and ASSUMPTIONS**

\*FY09 revenue includes a one-time gain on unbilled balance.

Sawtimber converted to cords @ 2 cords per MBF.

FY09 forecast SOLD cords wavg price = \$21/cd and REMOVALS cords wavg price = \$23/cd.

FY10 forecast SOLD cords wavg price = \$22/cd and REMOVALS cords wavg price = \$22.50/cd.

FY11 forecast SOLD cords wavg price = \$23/cd and REMOVALS cords wavg price = \$23/cd.

Timber sold \* 0.15 = sold portion TR.

Timber removals \* 0.85 = removals portion of TR.

SOLD / REMOVALS OTHER includes products sold by: #1000 lb, ton, piece, and per acre.

**Department of Natural Resources  
Natural Resources Planning Statement  
April 2009 Forecast Update**

	FY 2007 Actual	FY 2008 Actual	FY 2009 Planning Est(1)	FY 2010 Planning Est	FY 2011 Planning Est	FY 2012 Planning Est	FY 2013 Planning Est
<b>13.1 Forestry Management Investment Account</b>							
<b>Legal Citation: M.S. 89.039</b>							
Balance Forward In	6,497,722	9,065,146	5,848,635	383,885	(399,105)	(1,128,585)	(1,509,585)
Prior Year Adjustments	44,707	16,201	0	0	0	0	0
Adjusted Balance Forward	6,542,429	9,081,347	5,848,635	383,885	(399,105)	(1,128,585)	(1,509,585)
5348 Timber Sales (2)	5,893,701	5,297,011	4,301,000	3,884,370	3,978,240	4,200,000	4,410,000
5349 Timber sales interest and penalty	4,937	158,697	10,000	3,000	3,000	3,000	3,000
8000 Investment Income	348,047	202,041	100,000	100,000	100,000	100,000	100,000
8340 Credit Agreement Rebate		67	0	0	0	0	0
8360 Refunds of Prior Yr Expenditure	0	5	0	0	0	0	0
Subtotal Receipts	6,246,685	5,657,821	4,411,000	3,987,370	4,081,240	4,303,000	4,513,000
From Fund 200, CON. CON Areas Account (2)	2,428,469	3,070,133	2,248,250	2,219,640	2,273,280	2,400,000	2,520,000
From Fund 610, University Susp Account	31,898	30,743	40,000	35,000	35,000	35,000	35,000
From Fund 860, School Susp Account (3)	4,088,530	3,940,487	5,181,000	5,600,000	4,406,000	4,406,000	4,406,000
Total Transfer in	6,548,897	7,041,363	7,469,250	7,854,640	6,714,280	6,841,000	6,961,000
Total Receipts and Transfers In	12,795,583	12,699,183	11,880,250	11,842,010	10,795,520	11,144,000	11,474,000
<b>TOTAL RESOURCES AVAILABLE:</b>	19,338,012	21,780,530	17,728,885	12,225,895	10,396,415	10,015,415	9,964,415
Lands Records Management System	0	0	688,000	344,000	344,000	344,000	344,000
Forest Management	10,219,351	12,898,681	14,699,000	14,093,000	14,093,000	14,093,000	14,093,000
Enhance Sales FMIA (Appr. 302)	0	407,423	510,000	750,000	750,000	750,000	750,000
Forest Improvement FMIA (Appr. 303)	0	596,567	422,000	1,000,000	1,000,000	1,000,000	1,000,000
Forest Road Maintenance FMIA (Appr. 304)	0	787,131	303,000	0	0	0	0
Ecological classification FMIA (Appr. 301)	0	104,430	216,000	600,000	600,000	600,000	600,000
Invasive Species FMIA (Appr. 305)	0	87,198	143,000	350,000	350,000	350,000	350,000
Re-Inventory FMIA (Appr. 306)	0	116,542	275,000	400,000	400,000	400,000	400,000
Logger Refund - Relief Paymts Timber	0	851,122	1,000	0	0	0	0
Conservation Corps	25,000	25,000	25,000	25,000	25,000	25,000	25,000
Statewide Indirect Costs (Forestry)	28,515	57,802	63,000	63,000	63,000	63,000	63,000
Planned Reduction (1)				(5,000,000)	(6,100,000)	(6,100,000)	(6,100,000)
Total Expenditures	10,272,866	15,931,896	17,345,000	12,625,000	11,525,000	11,525,000	11,525,000
<b>FUND BALANCE</b>	<u>9,065,146</u>	<u>5,848,635</u>	<u>383,885</u>	<u>(399,105)</u>	<u>(1,128,585)</u>	<u>(1,509,585)</u>	<u>(1,560,585)</u>

- (1) FY 2009 planning estimate reflects \$5,426,000 in appropriation unallotments and a planned reduction in FY10-13 appropriations  
(2) FY09 April forecast on Acquired lands are adjusted from 20% to 22% and Con Con lands are adjusted from 25% to 23%  
FY10 Acquired lands are adjusted to 21% and Con Con lands are adjusted to 24%  
(3) FY10 based on on FY09 increase in costs. FY11-13 based on conservative 4-year average.