

DRAFT Minutes
Timber Advisory Committee
Wednesday, May 15, 2019 Meeting

The meeting was called to order by Ms. Katie Hagen, Chair, at 9:58 AM in Room 122, 450 N Street, Sacramento, California. Committee member Mr. Matt Dias representative for the Board of Forestry was not in attendance.

TIMBER ADVISORY COMMITTEE
MEMBERS IN ATTENDANCE

Katie Hagen, Chair

Charles Leonhardt
Mari Wilson
Leslie Morgan
Karl Weiland
Jennifer Perry
Marty Olhiser
Lennart Lindstrand, Jr.

REPRESENTING

California Department of Tax and
Fee Administration (CDTFA)
Assessor, Plumas County
Assessor, Humboldt County
Assessor, Shasta County
Assessor, El Dorado County
Assessor, Del Norte County
Large-Scale Timber Owners
Small-Scale Timber Owners

OTHERS IN ATTENDANCE

Susanne Buehler
James Dahlen
Mike Doyich
Art Tenneson
Mark Collins
Anna Snowden
Leslie Ang
Diana Lefort
Rachel Zou
Sandy Barrow

REPRESENTING

CDTFA, BTFD
CDTFA, PCB, Timber Tax Section
CDTFA, Legal Division
CDTFA, Office of the Director
CDTFA, TPB
CDTFA, TPB

1. Call to order and opening comments – Katie Hagen

Ms. Katie Hagen called the meeting to order at 9:58 a.m. Attending members were sufficient to reach a quorum, and the meeting was allowed to proceed. Ms. Hagen welcomed the committee to the meeting and acknowledged the two new committee members Ms. Jennifer Perry and Mr. Karl Weiland.

2. Introductions of New Timber Advisory Committee Members

Ms. Hagen asked the two new committee members, both county assessors, Ms. Perry and Mr. Weiland to provide a brief background about themselves and their experience as county assessors, and for everyone else in attendance to introduce themselves and state their affiliation.

3. Oath of Office

Ms. Leslie Ang from California Department of Tax and Fee Administration's (CDTFA) Legal Department administered the Oath of Office to the committee. The term of office for this committee is four years, expiring December 31, 2022.

4. Election of Officers

Ms. Hagen began the discussion on electing new officers for the new 4-year committee term. Mr. Mike Doyich, Senior Forest Property Appraiser (SFPA) explained that there are only two officer positions on Timber Advisory Committee (TAC). Chair, and Vice-chair/Secretary. The committee has the option of electing officers annually or for a specified term of their choosing. Mr. Marty Olhiser nominated Katie Hagen for the position of Chair and the motion was seconded by Mr. Len Lindstrand; motion carries. Motion to nominate Mr. Charles Leonhardt for the office of Vice-chair/Secretary by Mr. Weiland. Ms. Leslie Morgan seconded and motioned carried. Ms. Hagen asked the committee to discuss and vote on the term for committee officers. Mr. Weiland introduced a motion for a two-year term for the newly elected officers. Ms. Morgan seconded, motion carried.

5. Discussion and Approval of the November 8th & 27th, 2018 Meeting Minutes

Chair, Ms. Katie Hagen opened the floor to discussion for questions or comments regarding the meeting minutes from November 8th & 27th, 2018. Hearing none, Ms. Leslie Morgan introduced a motion to approve the minutes for November 8th & 27th. Lennart Lindstrand, representing Small-Scale Timber Owners, seconded the motion. Motion carried.

6. Opening comments on suggested immediate harvest values and general marketing trends

The chair passed the floor to SFPA Mr. Doyich who provided some historical background on the Timber Tax Program for the benefit of newly consummated Timber Advisory Committee. The Timber Tax Program came into existence on April 1, 1977 and was originally part of the Board of Equalization's (BOE) Property Tax Department until July 1, 2017, when the CDTFA came into existence.

The tax on timber is a property tax deferred until the time of harvest and is only due and payable when commercial timber is harvested. The tax is a self-reporting tax and is paid by quarter for the calendar year the logs are scaled in. Prior to the Timber Tax law, an Ad Valorem tax system included all commercial timber on each respective county's secured property tax role, whereby standing timber was included as part of the land value, and standing timber was assessed and taxed annually by each individual county assessor. The annual tax on standing timber became such a burden to many small size timberland owners that many landowners employed the practice clearcutting their lands to reduce

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their property tax burden. In the early 1970's California started its big push on environmental regulation. The California Forest Practice Law & Rules came into existence along with forester licensing, and California also enacted Timber Yield Tax Legislation as a means to encourage responsible forest management.

The Yield Tax system has some inherent flaws because it was designed in an attempt to fairly accommodate large industrial owners as well as medium and small timberland owners alike. For 42 years the yield tax system has withstood the test of time. Probably its biggest flaw is that under certain circumstances timber values can lag the market by as much as 6-months. The appraisal system is based on the market approach to value using only arms-length, open market transactions. The system recognizes several adjustments (or deductions) for low total volume, harvesting less-than 5 MBF per acre, and for costlier alternative logging systems to standard tractor logging, in order to help level the playing field for both the small and large industrial timberland owner alike. Timber values used for timber tax reporting purposes are separated into 9 different marketing areas, known as Timber Value Areas or TVAs. A TVA is defined as a region that has similar growing, harvesting, and market conditions. Over the years TVA boundaries have been reconfigured when needed to fit the times and marketing conditions. There are two regions in the State; the Coastal Region is comprised of TVAs 1, 2, & 3 and the Inland Region is made up of TVAs 4 through 9.

Timber Tax statute requires timber values be adopted no later than June 30th and December 31st of each year for use in tax reporting during each respective, subsequent 6-month period. TAC meeting dates, public comment periods, and all Timber Tax staff scheduling timelines are driven by these deadlines. TAC meetings are held twice annually, spring (May) and fall (November) to fulfill the required statute of twice annually adopting values. Special meetings are only called when there is a pressing need between regular meeting dates.

Beginning in 1977, and for over 20 years, TAC members served at the pleasure of the board. Sometime in the late 1990's or early 2000's TAC moved to 1-year terms, and members were appointed annually by the BOE. Over time, annual terms became problematic due to the time-consuming paperwork and annual oath of office requirements. In 2014 the BOE deputy director requested, and the Board approved, 4-year terms to simplify the logistical side of things. The first 4-year term just ending, began on January 1, 2015. The 4-year terms were designed to coincide with the mid-term election cycle when assessors are eligible to run for reelection, or step down. Once sworn-in, members can authorize an alternate representative with their proxy if they are unable to attend a meeting. Members also have the option of attending meetings by conference call if they are unable to attend in person. The only stipulation for conference calling is members must call in from a location that is accessible to the public and the Bagley-Keene Public Meeting Notice and agenda must be posted 10-days prior to the meeting date in a location that public notices are normally posted at that location; for example an assessor's office.

SFPA Mr. Doyich then introduced the appraisal staff and he also provided a summary of their extensive work experience. Each appraiser is a Registered Professional Forester with over twenty years of experience working in the private sector. They are all also certified property appraisers with the State Board of Equalization, each with extensive experience in the appraisal process and the overall Timber Tax Program as well.

Mr. Doyich explained the process the Timber Tax staff uses to develop the timber values that are presented to committee for their consideration every 6-months. The established Timber Tax appraisal process requires using the most recent 24-months of open-market sales data available. The system also employs the use of an index, developed and maintained in house, that uses quarterly sawmill quotes offered for delivered logs. This index simply measures change in log pricing (either plus/minus/ or no change) over the 24-month date range parameter used. Transactions with sale dates prior to the month of the appraisal are indexed forward in time, and this adjusted sale price indicates what the original purchase agreement would sell for on the appraisal date. Current month or current year sales are always a much more reliable value indicator than older sales. Typically, coming out of the winter period there are fewer sales in the database as compared to the fall, because many more open-market sales transact during the summer and fall months, which is the height of the logging season. Each month older sales drop out of the 2-year date range parameter as new sales are added in. Appraisers generally give stronger consideration to the more recent sales (current year preferably) when it is available. Appraisers do not round or average the sales data analyzed, they use their knowledge and appraiser's judgement of the markets and current conditions in their areas of responsibility. Suggested values are always presented in increments of ten whole dollars, since no appraisal can realistically be much more specific than that. Motions for changes to the appraisal staff's suggested values can be made by TAC members, or from members of the public, but requests for changes must be supported by tangible evidence for the committee's consideration.

Mr. Doyich stressed that maintaining the confidentiality of their sources and sales information is paramount to CDTFA's Timber Tax Program, and that any appraisal information given to TAC or the public is always in what is commonly referred to as *Summary Fashion and Source Neutral*. This insures that no confidential proprietary information of any company or individual can be singled out. He then explained how to read and interpret the information contained in the appraisal packages that was sent to them, as well as how to interpret and use the timber harvest value schedules that taxpayers use to report their Timber Tax liability.

4. Harvest Values for the Period of July 1, 2019 - December 31, 2019

a) Table G - Green Timber Harvest Values

In late 2018 after the bull markets of the past year and a half or so, log prices began to soften in September 2018. Even while Timber Tax staff worked on their appraisals during October of 2018, prices continued to fall even more. This is a classic example of the values that were proposed and adopted last time lagging current market conditions.

Subsequently, timber values were on the high side of the value range for the first half of 2019. The Camp Fire ignited on November 8th, which coincidentally was the day of the fall TAC meeting, and log prices continued to drop throughout the remainder of 2018. This trend continued through the first part of 2019 because lumber sales were down, log decks were full of high priced logs from the past year and log buyers anticipated another oversupply of low value fire salvage coming on the market. Some early April sales are indicating that prices have started to show a slight upward movement in some TVA's however, the past winter was one of the most severe and wettest on record, so current year log sales are off to a slow start. As a result of all of these factors, the proposed values for the second half of 2019 are significantly lower as compared to the first half of the year. With that, SFPA Mr. Mike Doyich opened the discussion on second half 2019 green timber values to the committee. After discussion regarding green timber values, Ms. Wilson motioned to approve green timber values as proposed for the second half 2019. Mr. Lindstrand seconded, and the motion carried.

b) Table S – Salvage Timber Harvest Values

Ms. Hagen moved the topic of conversation to the next item on the agenda, Table S, Salvage Timber Harvest Values, and opened the floor to Mr. Tenneson. Mr. Tenneson told the committee that salvage timber is generally valued lower than green timber for a variety of reasons. In general, salvage logging incurs higher costs due to the low amount of total volume and lower volume per acre removed. Since salvage timber is a perishable commodity with a limited shelf life, the quality of the wood diminishes with time, especially in the white fir. Pine also has the unique characteristic of *blue-staining*. This malady unique to all pine species is caused by an anaerobic fungus that stains or turns the normally light yellow or white color of pine to a bluish-gray color. This staining is not a structural defect but rather is a grade deduction that brings significantly lower prices in the market place. Whenever possible staff appraisers use comparable sales to value salvage timber, which is the same process as for green timber. But there are times when we do not have a lot of salvage sales in our databases, so in the absence of a significant number of salvage sales, appraisers rely on a proven method of using a percent factor of the green sale value of timber as an indicator for the salvage value. Historically 75% of green was the accepted norm, but over time internal studies have shown the percent of the green value varies over time, as well as by species. The percentage of green factors used for second 2019 values are as follows: Pine 45%; Fir 60%, Douglas-fir 60%, Incense cedar 60%, and Redwood/Port-Orford Cedar 75% of green. The percent of green factor is the ratio of salvage sales to green sales, by species, for the State as a whole. Timber Tax staff reviews the salvage value ratios annually and updates the ratios as necessary. Page 14 of the appraisal summary information packet displays an example of the salvage appraisal method used by TVA appraisal staff in developing the second half 2019 salvage values. Comparable sales were used to determine all the species salvage values in TVA 4. Due to the lack of recent sales, all other TVA's employed the use of the percent factor of green method.

There was some discussion about fire salvage vs. drought or insect killed timber by committee members. Mr. Doyich explained that very large fires go through phases of

salvaging and valuation, with 3 phases generally being the norm. Initially, before the markets are flooded and the stain factor in pine is low, landowners are basically logging large clear cuts removing large volume per acre; logging costs are low and values may be the same or comparable to green timber values. With the passage of time, the integrity of the wood declines and so does the value, logger availability often becomes more and more scarce and logging prices often increase due to higher demand. By the time the third stage rolls around log prices are very low, most of the fir is cull (worthless), the blue-stain factor in pine is around 100%, and very low volume per acre is removed. All of these factors tend to further increase logging costs and reduce the value of stumpage, or the return to the landowner. Upon the conclusion of the salvage discussion Mr. Linstrand motioned for approval of salvage values as presented. Motion was seconded by Ms. Morgan; motion carried.

c) 2Q & 3Q - 2019 Modified Harvest Values, TVA 7

Ms. Hagen recognized Mr. Doyich to open the discussion of 2Q19 Modified Salvage Values. Mr. Doyich explained that modified values are provided for in the Yield Tax Law in RTC Section 38204(b). This section of law basically states that when there is a large catastrophic event (like a large wildfire) and it creates a material change in the market in a very short amount of time, the Department can adopt modified harvest values to help with tax relief for innocent timberland owners victimized by catastrophic wildfires. Modified values are lower than regular salvage values and are effective for a calendar quarter rather than for 6-month periods like regular salvage. Modified schedules are designed to react quicker to rapidly changing market conditions, provide a tax break to those suffering financially (and emotionally) from a catastrophe, while still adhering to stringent review and public comment periods as required in the Yield Tax Law. Anyone can request a modified schedule, including a committee member, a taxpayer, or the Department itself. Mr. Lindstrand, the Small-Scale Landowner Representative on the committee requested this Modified Schedule for the Camp Fire at the November 27, 2018, special salvage values meeting. By definition, a Modified Schedule can be for an entire TVA, or *part thereof*. Historically, the term *part thereof* has been taken to mean a particular county or event. Mr. Doyich briefed the committee on details of the Camp Fire.

The fire burned mostly in the lower elevations around 2500 – 3000 feet, and this elevation zone is intrinsically heavier to the pine species. Other species such as White Fir, Douglas-fir and Incense Cedar normally grow more readily above elevations greater than 3000 feet, so lower volumes of these species are expected. The unique characteristic with the Camp Fire is the pricing structure that log buyers are using. Log prices are based on log length, rather than log diameter or log quality, as is usually the case. Larger logs generally have lower handling costs due to lower piece count, and tight grain, high quality logs of all sizes generally bring higher prices. The Camp Fire has an inordinate number of short logs being generated due to all the trees that had to be brought down in chucks with cranes to protect remaining buildings, homes and other infrastructure. PG & E has hired many local tree services to fall trees for safety and hazard reduction but once on the ground, these trees have been carelessly cut into random, non-specified log lengths so that logs can be moved and decked out of the way, thereby opening space to facilitate

other cleanup activities. All of these mis-manufactured logs have to eventually be bucked into preferred lengths; this not only creates waste that has to be dealt with but also higher costs as well. Short logs create a major handling problem due to the large piece count and the hauling problem they create. Log trucks already in short supply must use short log racks mounted on regular log trucks (known as *turkey racks*) since short logs will not bunk on a standard log truck. All of this increases logging and hauling costs. Higher costs and lower prices paid for blue-stain pine and short logs (regardless of quality) all contribute to reducing the value to stumpage, or return to the landowner. There is a total of 8 counties in TVA 7, and only Camp Fire salvage is priced lower due to log length. This places Butte County, and in particular Camp Fire salvage harvesters at a distinct disadvantage to the 7 other counties in TVA 7 when it comes to selling salvage timber. Therefore, the decision was made to restrict the modified schedule to Butte County, Camp Fire Salvage only.

The Camp Fire started on November 8, 2018, but ever since things in Paradise and the surrounding Camp Fire area have been in such disarray and combined with the long severe winter, and poor log market, that sales for Camp Fire Salvage have only just recently become available. Mr. Doyich stressed the fact that the modified values currently being proposed are therefore based on a very small sample size.

Ms. Morgan questioned the modified values being higher than regular salvage. Mr. Doyich explained that the comparison of modified values to salvage must be to the first half 2019 salvage values previously adopted last November and not to the second half 2019 salvage currently under consideration. As previously discussed the first half 2019 salvage values were based on a percent of green factor when the green values were much higher than currently proposed. At the conclusion of the salvage discussion, Mr. Lindstrand motioned to approve the modified schedule as presented. Mr. Weiland seconded the motion; motion carried.

Mr. Doyich told the committee that there won't be a 3Q19 modified schedule proposed for their consideration because green values for the second half of 2019 are so much lower as compared to the first half of the year, that after applying the percent factor of green to develop regular salvage values, it yields significantly lower values than the limited number of Camp Fire salvage sales indicate for modified values. In property tax, taxpayers are always offered the lower of two valuation methods. Mr. Doyich told the committee that staff would continue to monitor the situation and should a 4Q19 modified be needed, that matter would be addressed at the fall TAC meeting.

d) Table 1 – Miscellaneous Forest Products Harvest Values

Mr. Tenneson opened the discussion on miscellaneous forest products stating the only change in Table 1 products is in SSM, the Small Sawlog Miscellaneous category. SSM is down \$20 and all other miscellaneous forest products remain unchanged. With only minor discussion offered, Mr. Lindstrand motioned to approve Table 1 values as presented. Ms. Morgan seconded the motion. Motion carried, with all in favor.

5. Other Business

a) CDTFA Timber Tax Program

Ms. Hagen talked about the new central operating computer system that will be coming soon to Timber Tax. The system is known as CROS, or Centralized Revenue Opportunity System, and the new system will go live on August 12, 2019.

Mr. Linstrand wanted to know how filling the vacant appraiser's position was going and how staff was handling the current workload. Mr. Doyich said they are managing to get by, but that it is very challenging handling everything with such a small appraisal staff. Ms. Hagen said they are actively trying to fill the vacant appraiser's position, but that it is difficult because the work our appraisers do is so unique. She added they need to look into statutory and regulatory considerations in order to be able to bring more resources to the Timber Tax Program to aid with recruitment. Mr. James Dahlen stated that a new job advertisement will be posted tomorrow for the associate appraiser's position and that the new notice is designed to reach a wider audience; he asked the committee for any other suggestions on where to post the notice. Mr. Lindstrand stated the best organization to advertise with is the California Licensed Foresters Association. Mr. Dahlen said he has already begun working on that. Mr. Lindstrand also suggested he try the Society of American Foresters.

6. New Business

The next TAC meeting was scheduled for Wednesday, November 14, 2019, at the same location 450 N Street, Room 122, Sacramento, CA 95814. The meeting was adjourned at 11:58 a.m.