

TRANSCRIPT

PENSIONS FOR PURPOSE PODCAST – SERIES 1, EPISODE 6

INVESTING IN TIMBERLAND – WITH CHARLOTTE MOORE, DAVID BROWN AND STEPHEN LEVESQUE

Charlotte Moore: Hi, welcome to the latest edition of the Pensions for Purpose Podcast. I'm Charlotte Moore and I'm your host. I'm delighted to welcome David Brown, Senior Director for Pensions for Purpose. It's his first podcast so we have to be gentle with him! I'm also very happy to welcome Stephen Levesque, Managing Director of Forest Operations at Campbell Global, a J.P. Morgan company. Today, we're going to be talking to Stephen about trees. So, welcome to the show, Stephen, and that is the most fantastic job title I've come across in the world of finance, Managing Director of Forest Operations! Your fund specialises in planting and growing trees. Tell us a bit more about what you do and the appeal of this asset class to investors.

Stephen Levesque: Well hello, thank you for having me. It's a pleasure to be here today and talk trees. My favourite subject! I'll start by sharing that our firm was a pioneer in the asset class and has had 40 years of experience in timberland investing. And while a lot has changed over that time horizon in terms of where we invest and the global trade of products, for wood, some things haven't changed. And that really is about the fundamentals for the timberland and asset class, and what investors have been attracted to over the years. And it's very straightforward. One is the steady yield that comes from the harvest and sale of sustainable wood products. And I'm sure we'll talk about that more. There's also the diversification benefits. And, finally, and maybe most relevant recently, is the hedge against inflation and that our asset class tends to perform higher in higher periods of inflation, negatively correlated to some other asset classes. And what's really exciting, particularly for me with my biology and forestry background now, is that we're really at an inflection point where some investors are looking beyond those fundamentals and also very attracted to the co-benefits for making positive impacts relative to climate and biodiversity. And so you also asked just briefly here, how? How do we deliver these outcomes and these benefits to our clients? Well, we've honed our thesis, in our practice, around investing in what we call the core regions around the globe. So that would be North America, Australia, New Zealand, Chile and Latin America. These regions all have mature markets, good science on growing trees, which is critical, and they respect the rule of law. And so within these regions our focus is really on softwood trees. Trees with leaves, I mean, excuse me, trees with needles, not leaves. We like trees with leaves but the commercial focus is on growing larger, older softwood trees. They're going to get converted into long-live products to support sustainable housing, residential, commercial, repair and remodel. And lastly, and I think very importantly for this group here, is that all of our properties are managed sustainably and in accordance with rigorous, independent certification standards. And, quite frankly, our mission is to create a healthy, resilient forest condition that is going to be, withstand the effects of climate change and other potential disturbance that we might see, nature brings our way, and I'll leave it there for now.

Charlotte Moore: Okay, that's, thank you for that fascinating little introduction. Just want to pick up on a couple of points there. I think you touched on one of them. But you talk about positive carbon benefits and the impact of biodiversity. Let's take biodiversity, first of all, because there is a concern isn't there with forestry that actually it little to do with biodiversity, and actually can have a negative impact on biodiversity? So how do you make sure that you are actually having a positive impact and creating more biodiversity rather than a monoculture that reduces rather than improves that biodiversity?

Stephen Levesque: Well, I think the forests that we manage are generally, have been managed in a commercial form for generations perhaps and so the alternative of passive management is going to lead to overcrowding, a higher risk of wildfire and perhaps even in more negative impacts for biodiversity. So it really goes back, first and foremost, to creating that healthy, resilient forest condition, protecting that forest cover that that we're losing around the globe every year, but more specifically, as part of our pre-purchase acquisition due diligence, we work hard to identify the range of potential species that could exist on that landscape and identify what their habitat needs are. And we can talk about this in more detail, but really tailoring our management to make sure that we're not doing any harm, that we're not creating nature loss. And what I love about the business is, every property is different, a different range of species, both from a forest tree standpoint, but also from a biologic standpoint. It might be, you might be working with koala bears in Australasia. You could be working with gopher tortoises in North America but I'd say it takes purposeful intention to understand what's out there. And then, as it relates to monoculture, I like to point out, and I'll use an example from the US South, if you have a 100,000 hectares of commercial forest land in the US South, 70% to 75% of that, on average, is going to be in more plantation, in single specie, but the other 25%-30% is this mosaic of natural areas, wetlands, river bottoms, fens. And so we manage for that mosaic, to create as much complexity as we can on the landscape.

Charlotte Moore: Okay, let's bring, let's bring David into the discussion now. Give us a feeling of what you're hearing from pension schemes about forestry? Is there interest? Where is it coming from? Are they interested from the carbon perspective? The biodiversity perspective?

David Brown: Yeah, absolutely. I think pension schemes are increasingly looking at forestry and timber. And I think, why would they be doing that? Well, there are many reasons why they should actually be doing that. But probably, first of all, be good to just take a little step back and think about the environment in which pension schemes are actually operating. So, many pension funds now set net-zero targets, as they understand the systemic risks that come from climate change and biodiversity loss. And additionally, for larger funds with over 1 billion in assets under management, they're now considering the Task Force on Climate-related Financial Disclosures (the TCFD) reporting where, amongst other requirements, they need to consider risks and opportunities on climate change. And other pension schemes are also thinking about the TNFD disclosures around nature and biodiversity more generally. So, against that background, it's not surprising that some pension funds are considering investing in forestry and timber. And I think the key word being here, some pension funds. So for some pension funds, they might be on a different part of their journey. They might be more mature. They might be thinking more about liquidity and cash flows and paying benefits for today. Or they might be closer to securing their liabilities with an insurance company so, therefore, less likely to consider forestry and timber. But for those that are considering forestry and timber, there are many reasons for this and I'll share, quickly, five with you now. The first one being purposeful impact. So alignment to the sustainable development goals and, specifically here, I'm thinking about SDG 13, around climate action, SDG 15, around life on land. So we see this specifically with some of the local government pension scheme funds and the associated investment pools being aligned to the SDGs. As Stephen's already mentioned, the second reason being that forestry and timber is a great diversifier to traditional asset classes, such as equities and bonds, in that forestry can offer steady returns with lower volatility, which is important for pension funds that are looking to protect their funding levels. The third reason being around the long-term nature of the pension schemes. So pension schemes that have invested in forestry, such as Nest, the LGPS funds and the Pension Protection Fund, all have those very long-term investment time horizons. And then, fourthly, forestry and timber can be part of the solution here, to become net zero by using the carbon credits available from forestry to offset emissions elsewhere that occur within the investment portfolio. And then, finally, my fifth reason would be member engagement. Members can physically see and feel forestry and trees. And so these type of assets, that are important to help us meet our climate and biodiversity challenges, can really really resonate as part of that member engagement journey.

Charlotte Moore: Yeah, it's one of those things where you can't really, apart from standing in the stock exchange and ringing the bell, you can't really see or touch your investment, but you can see and touch a tree. Let's pick up on some of the points you raised there, David, about carbon, because that, you mentioned, Stephen, that it was about you wanted needle trees that had wood, that could be used for long term. So let's talk about how you, what are the carbon benefits of forestry? And also David mentioned carbon credits. So if you could talk about that a bit?

Stephen Levesque: Absolutely. And certainly I'm biased but I believe the trees really represent the most cost-effective and most efficient technology right now to store carbon. And, in the short term, trees offer a short-term, mid-term solution that's really critical to meeting those larger climate goals and some of the investor targets that were just referenced. So when we think about managing carbon on the landscape, it's across that whole mosaic, every acre, every hectare contributes, and we develop long term management plans and conduct our harvest operations in a manner that year over year we're storing more carbon out on that forest than we're actively removing from timberland harvest. So you think about this big forest out there, we have this pool of standing carbon in the stems and the branches, and year over year we're making sure, and we can calculate this, that we're growing, sequestering more carbon, adding to that pool. We also, in forestry, can use different protocols to develop carbon offset projects, as was also referenced for generating high quality, tangible carbon offsets that then can be used for investors to reduce unavoidable emissions in their supply chain. But, again, similar to biodiversity, it very much takes a lot of science and a lot of purposeful intent to be able to put these forests on a management trajectory, to achieve those outcomes.

Charlotte Moore: Then give us a little, you touched on it before as well, but give us a little more detail about actively managing this asset class. You talked about how it's important to kind of keep forestry, you know, in the best possible shape that it can be. But tell us about how active management can help sequester the most common carbon and actually improve the biodiversity. I think there was something about owls in California or something like that?

Stephen Levesque: Yes, I'm happy to share some stories about owls. But you know, first, when it comes to the active management and thinking about it, from my perspective, it's like tending a very large garden. And not all of the properties that we acquire have been tended very well over time. So maybe there's too many trees in a certain area or not the right species that's native to the area. So sometime there's some restoration work in order. But really, it's managing the life cycle. And in every one of those regions that I mentioned, there are different life cycles depending on how trees grow and how long it takes to reach maturity, whether it's 18 years in Chile or 45 years in the US West. And what we do for treatments along the way. And so for every tree harvested, three or four more are planted, and we have to select the best trees to control the vegetation, think about soils and deficiencies, do we need nutrients? And we leverage a lot of science to do that. So that's really the forestry side of the house and that's how we create a lot of value. And we talked about the yield but there's a strong element of capital appreciation that comes from the asset class, and that's that tending to the garden. The better, higher quality trees that we have out there are worth more and will be valued as such. Now on the biology side, just again, Northern Spotted Owls, it's a federally-endangered species, state-endangered species in the US West along the Pacific coast. And what's fascinating about the species is they require three different types of habitats. They require one type of habitat for nesting, another for roosting, and a third for foraging, looking for mice and other critters on the ground floor. And the owls generally live mostly within a 0.7 mile radial, radius circle from their nest, and they generally forage out to about 1.3 miles. So within those two concentric circles, we have to develop a management plan and perform active treatments, to create that series of different habitats, to make sure that those species are viable. And it all starts with us sending biologists out in the woods to find these nests. And they literally go out at night and hoot,

Charlotte Moore: [Laughs]

Stephen Levesque: and all these birds in, and then follow them back to their nest. And then that's where, you know, the planning and the execution begins to make sure we've incorporated that into our work.

Charlotte Moore: And I wonder, it's just a question that's occurred to me. Is there a kind, is there an opportunity for kind of, maybe a little bit of sort of conservation around the edges. Not just, you know, if you have a variety of trees, but can you leave extra trim, extra edges that can be kept completely wild as long as they're natural local species. So you encourage biodiversity in that way?

Stephen Levesque: Yes, we identify those areas. And particularly for special sites, maybe it's a high elevation meadow with some rare plants, you know we'll take that out of production and write a management plan. Sometimes those high mountain meadows, they need special treatments or the forest is going to encroach on them, because like fire has been taken out of the ecosystem. So we look at, how do we restore areas? I talked about the gopher tortoises in the US South. Well, the gopher tortoises can't crawl over a lot of debris to get inland to make their burrows and so we have to manage that debris on the landscape. So that there are corridors for the wildlife to travel. So yes, all those factors play into our day-to-day management decisions.

Charlotte Moore: So we've talked about gopher tortoises. We've talked about biologists hooting in the night, which I guess could be a euphemism for something else! [Laughs] But let's move back, maybe to safer and sounder financial ground. Let's talk about some of the nitty, gritty details of this asset class. I know that David's keen to hear about this. Can you talk to us, maybe, Stephen, a bit more about the sources of yield for investor, for the investor?

Stephen Levesque: Yes, historically, 80% to 95% of the yield would come from the sustainable harvest of mature trees or intermediate trees during thinnings. That has historically been the main driver. As I said, every property is unique and there are what we call alternative revenue stream opportunities that perhaps we may be able to take advantage of and add more to the bottom line. Carbon credits is certainly one of those that on a go-forward basis we think are going to contribute more to yield than it has historically. But also we lease out mountaintops for cell phone towers. We may have recreational leases in certain areas. So there's other ways that we can generate income. Conservation easements, monetising, protecting landscapes into perpetuity is another important vehicle that we use. And so we, we really focus on, first and foremost, though, is that primary driver of the harvest and knowing that we're getting the maximum utilisation out of every single tree. And the easy part is really cutting the tree down at the end; the art and science is cutting it up into the right pieces to get the right mill to maximise that margin. And then also, one of the beauties of the asset class and why it has performed well over time is, when markets are soft, we don't have to cut those trees. They can continue to stay in the stump and the sunshine is free, and they're going to continue to grow and add value, and we can harvest them when the market cycle is up. So those are the primary drivers.

Charlotte Moore: And what about the lifetime of the asset class? How long does the tree, assuming the market is in its favour, stand before it gets chopped down?

Stephen Levesque: Well, you know, when we, when we buy a property, it's got a mix of all ages. You'll have everything, just planted, ready to harvest and a whole bunch in between. When you think about fund terms, it's really interesting. And you have, I would say, a wide range of, say, commingled funds with 10, 12 or 15-year windows. But you also have funds that are evergreen or perpetual in nature and on the similar, I would say, on the separately managed accounts. So some people have more of a closed-in view of the world but others much more long term, as was mentioned previously. And so we're happy to tailor, at least our work with different investors, to meet those different period objectives.

Charlotte Moore: Okay, so we we're doing well on the tree puns. We've managed to get evergreen in there. Now, we just need to talk about green shoots! [Laughs] You mentioned the fund structures there, something else that's of interest to me, and then I'm going to hand over to David to see if there's any other questions he has, are you interested only in existing plantations or are you creating new forests too?

Stephen Levesque: Well, historically, we've really focused on existing commercial forests. Maybe within those commercial forests there were areas that could be restored. But really that was incremental. But, as we look to the future and we look to the opportunities timberland investors have with the forest carbon offsets, afforestation, or establishing a forest where one didn't exist before, is certainly going to be a key part of our strategy going forward. Essentially taking, perhaps, degraded farmland and then establishing again a mosaic of different species, trees. Really focused on growing carbon but doing it in a manner that it's a working for us, so it will be sustainable. And if, let's say in 10 or 15 years, some amazing technology comes by and offsets are no longer needed, you still have a healthy forest that can generate yield. But yeah, afforestation, it's really exciting to think about creating a whole new forest where one didn't exist before. It won't be the bulk of our business but it will be an important slice.

Charlotte Moore: Okay. Any other questions, David, on the nitty gritty for Stephen?

David Brown: Yeah, absolutely, Charlotte. Maybe I can start with a comment first and then I'll go to my question. So the comment I was going to make is, it's fascinating to listen to Stephen and the specialist nature of forestry and timber, and all the factors that are actually involved. And I can't, I'm just thinking now, from a history perspective, I mean as recently as the 18th century, for any particular ship on the ocean it would be about 2,000 oak trees that had gone into that. And, at that stage, it would have been all about simply logging and destroying the countryside of our tree cover. So to hear where we are today, it's chalk and cheese, how the market's actually developed and really, really positive in helping us meet our challenges. But a specific question I had for Stephen, we focus so much today around the E of ESG, and Stephen, you mentioned a little bit around recreation. I'm thinking now of the S of the ESG, so presumably there'll be wider benefits from a society perspective, alongside recreation, potentially local employment. I wonder if you could expand

Stephen Levesque: Uh hmm.

David Brown: a little bit on that for us?

Stephen Levesque: No, it's a great question. I know we tend to focus a lot on the E but the S is a really critical part of the business. You know, we can be one of the largest or largest employers in a rural community, providing those living wage jobs, property taxes, recreation. You know, we generally, we like to follow local customs. We like to fit in and be neighbourly and so in some areas, like I mentioned the US South where there's a longstanding history of doing recreational leases, we do that. In other areas around the globe, we often just allow non-motorised traffic to recreate on our properties. And so yes, I think it's really important. We'll have firewood-cutting days for neighbours that want to come out and get wood. And so the more we can interact with those communities. And then there's also quite a bit of reciprocation, too. For example, we provide domestic water for many small rural communities and the city of Seattle's main water line runs right through our property up in Washington State. So there are a lot of interaction dynamics, you know, with local communities which are again critical to us being able to operate, and with some surety, in a neighbourly manner.

Charlotte Moore: Yeah, I'm really interested. By the way, you were talking about the reforestation, the conservation and the S that David has mentioned. I mean, I can see, for example, in the UK, where our biodiversity is heinously undepleted, I can imagine, I can visualise a situation where we have a beautiful area that's been reforested and rewild, and that's open to people to enjoy. I think that would be great vision to the future. And just to make one other point today, which is my, so the woman with the blonde hair here, there's a reason why I have blonde hair. It's because I'm half Danish. So if you're ever in Denmark, you're ever in Copenhagen, you have to go to the Roskilde Viking Museum, and there's a wonderful bit in there where they talk about which different types of trees they used to build different parts of the Viking ships, because different trees had different, different types of wood had different types of properties. So ash would be favoured for certain things and then other trees would be favoured for the oars or favoured for the mast, etc, etc. So yeah, there's a long history of using wood and using trees.

Stephen Levesque: And on the note of getting people behind the gates, you know, as David mentioned, many people have perceptions in their mind of what's happening behind the gates. And so we found the more people actually go out in the forest, and they see that mosaic and they see that range of conditions, that changes minds.

Charlotte Moore: I think, I think I can agree with David and say we've had a really fascinating discussion so far. So I've just got one final question for Stephen and then I'm going to ask you what you want your key takeaways for our listeners today. So just, final question Stephen, is there a particular aspect of this asset class which you find of interest to UK and European pension schemes? Is it the carbon? Is it the biodiversity? Is it the yield? Or is it all of the above? Particularly for those long-term investors, the UK and European pension schemes.

Stephen Levesque: You know, to be honest, I think of it as kind of a standard bell curve. On one tail you have people that are only interested in the timber fundamentals, on the separate tail you have people that are really only interested in carbon and meeting some climate objective. But I think the bulk of the people are in the middle, where they like the blend. They like the notion of investing wisely and responsible, and something that has these fundamentals but also brings along some co-benefits. So it's really been fascinating as we've travelled around and met people across that bell curve of interest levels. For, you know, tying back to David's five key points, it ranges by investor and David has probably seen that himself.

Charlotte Moore: Okay, so I'll turn it to David. What, for our listeners out there, if there is one key takeaway that you want them to have from today's discussion, what would it be?

David Brown: Oh, that's a challenging question, Charlotte. I'd have to say that, let me start by looking at where pension schemes are coming from. They're looking at diversification. Typically, they've invested in equity and bond mandates, and they're now currently looking to go into private markets. Increasingly, for many reasons, one being illiquidity, illiquidity premium available. I have to put my teeth in for that one!

Charlotte Moore: [Laughs]

David Brown: So, typically, this is focused on assets such as infrastructure and real estate. So my takeaway would be, for anyone listening today, to ask your investment adviser or governance committee that you're actually associated with to give consideration to this asset class of forestry and timber. It offers strong investment growth potential as we've heard today. And one point I'd link to that, timber consumption is expected to more than double by 2050. There's, and an example of where that growth is going to come from, lots of timber goes into housing and, as we know, there's pent-up demand in many markets, including the UK and US for housing. So there's going to be a lot more need for wood consumption. So, against that background, it's got good investment characteristics which is what a pension fund is looking for. But also, as you've heard through the course of this podcast, it offers all the climate and biodiversity benefits that Stephen's taken us through, that a well-managed forestry fund can offer.

Charlotte Moore: And Stephen, final word to you, what would be your key takeaway that you would want people to have from this podcast?

Stephen Levesque: I would reiterate that we're at an inflection point and that many investors are looking at these properties for a variety of different purposes. And to David's point, you know, the demographics are in our favour. Population, housing, we need affordable housing around the globe and wood is the best source to solve that problem. But forestry and healthy forests are scarce, becoming more scarce as the interest grows. And then some investors really interested in that far side of the tail with carbon are really not managing for wood products. They're managing for carbon and that could tighten the supply. So there's some really interesting dynamics as we work through this inflection point. And I would say, my final closing point is that the next 10 years is going to be different to some extent than the last 10, given all these variables that we've talked about today, it's an exciting time to be in the forestry world.

Charlotte Moore: It's an exciting time, indeed, to be Managing Director of Forest Operations. Still, the best job title on this podcast, so far! I want to say, thank you to both my guests for that fascinating talk. I don't think we've ever managed to squeeze in biologists, owls, tortoises and Viking ships into one podcast before. Thank you for sharing your insights and letting us learn more about forestry. Thanks to our listeners, we hope that you are enjoying this series of podcasts and you continue to listen in the future.