Memorandum

Date: September 3, 2020

To: Members of the State Coastal Conservancy

From: Sam Schuchat, Executive Officer
Karyn Gear, North Coast Regional Manager

Re: Amendment of Garcia River Forest Revenue Sharing Agreement, Project No. 03-151

Attachments:

Exhibit 1: December 11, 2003 State Coastal Conservancy Staff Recommendation

Exhibit 2: Agreement Providing for Special Covenants, Conditions and Restrictions, entered into on February 4, 2004 by TCF, TNC and the Conservancy; and Amendment No. 1 to Agreement Providing for Special Covenants, Conditions and Restrictions, entered into on February 7, 2011 by TCF, TNC and the Conservancy.

Recommendation Summary:

Staff recommends the Conservancy amend its current revenue sharing agreement with The Conservation Fund (TCF) related to the Garcia River Forest, a working forest acquired by TCF with a Conservancy grant. TCF has proposed the amendment, which would allow for an immediate $5,000,000 payment to the Conservancy in exchange for termination of the Conservancy's right to receive, over time and dependent on net revenues, $5,000,000, plus additional unknown amounts, of future property revenues. The amendment would also provide that if TCF enters into a purchase and sale agreement with a private, for-profit entity by May 31, 2021, the Conservancy would receive, in addition to $5,000,000, one-third of sales proceeds above the current property valuation of $19,900,000. In accordance with Public Resources Code Section 31011, the $5,000,000, and the additional funds from a sale, if any, would be placed in the State Coastal Conservancy Fund and would be available to the Conservancy upon appropriation by the Legislature. As the Conservancy has already received $1,000,000 through a prior revenue sharing payment from TCF, the Conservancy would essentially have achieved the project's conservation goals of protecting 23,780 acres of working forest lands and improved wildlife habitat at no cost to the Conservancy.

The revenue sharing agreement was a condition of the Conservancy's 2003 grant to TCF for acquisition of the Garcia River Forest property for habitat and resource protection, open space preservation, sustainable timber harvest, and public access. The Conservancy required the revenue sharing because the property was expected to generate revenues from the timber harvesting. The property has since generated revenues from a carbon sequestration project as well as timber harvests, and the Conservancy has received $1,000,000 to date under the agreement. TCF has proposed the amendment because it has an unexpected source of short-term funds and, for its own financial purposes, TCF would like to pay the Conservancy now and reserve future revenues for other purposes. Staff recommends the amendment because the Conservancy's receipt of revenues under the agreement is dependent upon the property generating revenues and is thus uncertain. Therefore, even if the Conservancy could potentially obtain more than $5,000,000 under the agreement over time, amending the agreement to assure receipt of $5,000,000 now is beneficial to the Conservancy.

The property is protected for the acquisition purposes by the Conservancy's reversionary interest and a conservation easement held by The Nature Conservancy (TNC). At the time the TCF purchased the property, TCF and the Conservancy contemplated TCF's transfer of the property to a private, for-profit entity. If in the future the Conservancy approves TCF's transfer of the property to a private, for-profit entity, the Conservancy would remove its reversionary interest, and the property would be protected for the acquisition purposes by the conservation easement, which would remain in perpetuity with third party beneficiary rights for the Conservancy.

Proposed Resolution

Staff recommends the State Coastal Conservancy adopt the following resolution, pursuant to Sections 31000 et seq. of the Public Resources Code:

"The State Coastal Conservancy hereby authorizes the Executive Officer to amend the Conservancy's revenue sharing agreement with The Conservation Fund for the Garcia River Forest to provide for an immediate payment of $5,000,000 and termination of the Conservancy's rights to receive a share of any future revenues from the property, provided that if TCF enters into a purchase and sale agreement with a private, for-profit buyer for the property on or before May 31, 2021, TCF shall also remit to the Conservancy one-third of any sales proceeds over the existing property valuation of $19,909,000."

Project Background

In December 2003, the Conservancy authorized a $10,000,000 grant, of which $4,000,000 was required to be repaid, to The Conservation Fund (TCF) to acquire the approximately 23,780-acre Coastal Forestlands property, now known as the Garcia River Forest, in the Garcia River watershed (See Exhibit 1: December 11, 2003 Staff Recommendation). The $4,000,000 repayable portion of the grant was repaid to the Conservancy in 2004, via a grant to the Conservancy from the Wildlife Conservation Board. The total cost of the acquisition was $18,000,000. TNC contributed $3,500,000, and the remaining funds for the acquisition were provided by TCF through its own capital and a loan from the Packard Foundation, which has been repaid with project revenues.

The acquisition was the Conservancy's first foray into large scale working forest conservation and was then an innovative approach to protecting coastal forest habitat in California at a landscape scale. Prior to this initiative, coastal forest conservation had largely been achieved by nonprofit organizations and public agencies acquiring forestlands and managing them as parks. While this was often the appropriate method of conservation, limited public land management funds required the development of new conservation models. The project sought to prove TCF's hypothesis that depleted industrial timberlands could be restored to healthy working forests with the co-benefits of fish and wildlife habitat protection and improved water quality through patient management by a nongovernmental organization. Revenues from timber harvests carefully planned to restore forest structure were expected to provide the income needed to manage the property.

Since the 2003 authorization, the Conservancy has authorized funding for two additional forest conservation projects with TCF. In 2006, the Conservancy authorized $7,250,000 for the acquisition of the 16,363-acre Big River and Big Salmon Creek Forests in Mendocino County, and in 2013, the Conservancy authorized $10,000,000 towards the purchase of the 19.600-acre Preservation Ranch property (now known as the Buckeye Forest) in Sonoma County. Both of these authorizations had similar project goals to the Garcia Forest, and both have revenue sharing agreements. As the financing for the Big River/Salmon Creek project included a $20,000,000 loan from the State Water Resources Control Board's Revolving Loan Fund which is being paid off with forest revenues, there has not yet been net revenue to share with project partners. The Buckeye Forest, however, has produced net revenues from the sale of carbon credits, and to date the Conservancy has received three revenue distributions totaling $1,846,134.

As required by the Conservancy's 2003 authorization, TCF prepared a management plan for the Garcia River Forest, approved in 2006 by both the Executive Officer of the Conservancy and TNC, and updated in 2017. The management plan contains the following management goals for the forest:

• Improve ecological conditions by protecting and enhancing water quality by maintaining high standards for road construction and maintenance.

*Improve ecological conditions by protecting and enhancing terrestrial and aquatic habitat vegetative diversity, late-seral conditions, and riparian forests on the Forest, while significantly increasing the inventory of commercial timber volumes.

• Generate sufficient revenue to cover Forest taxes, on-site maintenance, management, and restoration projects.

• Continue to implement improved forest management greenhouse gas reduction projects first registered under the Climate Action Reserve (CAR) Forest Project Protocol version 2.1 and now transitioned to the California Air Resources Board Compliance Offset Protocol, U.S. Forest Projects.

• Practice continual improvement through adaptive management based on monitoring of water quality and forest health against specific objectives described in the Plan.

• Support the local business community by utilizing local contractors and suppliers.

• Involve the local community by seeking input on management of the Forest, including review of this Plan and timber harvest plans implemented under the Plan, and providing compatible public access, educational, and recreational opportunities.

• Maintain at least 35 percent of the Forest as a permanent Ecological Reserve Network, which shall include oak woodlands, grasslands, riparian areas and other areas with high value conservation features.

Under TCF's ownership and management, much has been accomplished to further the management plan goals. Juvenile coho salmon collected from the property are being used in the California Department of Fish and Wildlife's brood stock program and will eventually bolster the Garcia River's coho population. The entire 270-mile road network on the property has been assessed, which involves identifying each location along the road with the potential to deliver sediment into streams, mapping the sites, prioritizing projects, and recommending treatment prescriptions. To date 78% of the identified sites, including all the major issues and all the sites in the highest priority subwatersheds of Inman, Signal and North Fork, have been treated to remediate the threat of sedimentation in streams. Over $2 million has been spent repairing or replacing 75% of the property's critical infrastructure, including 4 bridges. Fish habitat has been improved by placing large woody debris (LWD) in all the reaches of small to medium sized fish-bearing streams that are accessible; some sites may receive more LWD in the future, and TCF will develop opportunities to implement larger engineered projects on the main stem Garcia in the coming years, as well as expanding LWD projects to some of the lower level priority streams on the property. TCF has accomplished all of this work using a mixture of grants, private fundraising, and revenues from the property. In addition to the habitat goals, TCF has undertaken timber harvests, with the goal of improving the forest structure, while providing some modest revenue to assist with property management costs, has received forest certification through both the Forest Stewardship Council and the Sustainable Forest Initiative, and has registered the forest as an improved forest management carbon project.

Revenue Sharing Agreement

Because there was the potential that at some point in the future the property could generate revenues that exceeded the cost of property management and that the property could be sold to a private, for-profit entity to manage subject to the conservation easement, the Conservancy's 2003 authorization required TCF to enter into a revenue sharing agreement with the Conservancy. At the time of the acquisition, revenues were expected to be derived largely from timber production, but a few years later, the opportunity to participate in the carbon market emerged, and TCF worked through the arduous process of registering the forest as a carbon sequestration project. TCF first registered the forest in 2008 through the Climate Action

Reserve's Early Action Program which sold carbon credits in the voluntary market. In 2015, TCF transitioned the project to the California Air Resources Board Climate Offset Protocol, selling credits in the regulatory market. While highly complex, and requiring a significant investment to prove up and monitor the carbon stocks on the property, the income stream provided by carbon credits sold from the forest has been significant, and has enabled TCF to successfully manage the property, in times when the income from timber sales would be insufficient to cover costs. The carbon revenue has also enabled TCF to carefully plan its timber sales to coincide with periods when timber values are up.

TCF, TNC and the Conservancy entered into the revenue sharing agreement, titled "Agreement Providing for Special Covenants, Conditions and Restrictions" on February 4, 2004 and amended it on February 7, 2011. (Attached as Exhibit 2.) The agreement outlines the amounts and order in which revenue generated from the property would be dispersed as follows:

1) To TCF for ongoing costs of owning, operating and managing the property;

2) To TCF to repay a $2.5 million loan TCF took to acquire the property;

3) To TCF to implement enhancement and restoration activities called for in the management plan;

4) $1,000,000 to the Conservancy;

5) $1,000,000 to TNC to create an endowment for costs associated with monitoring the Conservation easement;

6) $5,000,0000 to the Conservancy;

7) $2,000,000 to TCF;

8) $3,500,000 to TNC; and

9) Any additional revenues to be disbursed evenly amongst the Conservancy, TCF and TNC.

The agreement provides that if the property were sold to a private, for-profit entity, proceeds from the sale would be distributed as set forth above, and the revenue sharing agreement would terminate.

While priority #1 and 3 above are annual costs that vary from $1 million to $2 million per year, over the course of its 16-year ownership, TCF has generated enough revenue from the project to work its way through priority #5. The loan (priority #2) was paid off first, and then the Conservancy received $1,000,000 in 2013 pursuant to priority #4 above. This year TCF remitted $1,000,000 to TNC pursuant to priority #5. Under the agreement, the Conservancy is next in line to receive $5,000,000, which is to be paid out of revenues remaining after priorities #1 and 3 are paid each year. Due to the annual ups and downs of carbon market and timber costs, inherent risks of property ownership, and property management and habitat restoration expenses, it is expected that remittance of the $5,000,000 would be spread out over a number of years, with no guarantee year to year of any revenues.

Proposed Revenue Sharing Agreement Amendment

In May of this year, TCF approached the Conservancy with a proposal to use non-property revenues to pay the Conservancy's $5,000,000 immediately in exchange for terminating the Conservancy's right to receive any further property revenues, including its right to receive revenues from a sale of the property. TCF's proposal also includes paying TNC $3,500,000 immediately and terminating their right to future revenues. TNC has reviewed the proposal and intends to accept the offer with the condition that if TCF finds a private, for-profit buyer for the property by May 31, 2021, TCF must split proceeds in excess of the existing property value with TNC. TCF has agreed that if it enters into a purchase and sale agreement with a private buyer before May 31, 2021 TCF will pay both TNC and the Conservancy one-third of any sales proceeds over TCF's existing property valuation of $19,909,000.

TCF appears to have several motivations for requesting this change to the revenue sharing agreement. Last Fall, the Conservation Fund issued a $150,000,000, 10-year "green bond" bearing interest at 3.7% to fund acquisition of working forests throughout the country. Purchasing the Coastal Conservancy's future revenue share in the Garcia River Forest with proceeds from the green bond will allow TCF to use net revenues from the Forest to cover some of the interest expense on the green bonds while it identifies other conservation projects in which to place those funds. Secondly, by retiring the revenue sharing agreement, TCF simplifies its annual reporting requirements, easing its administrative burden.

Proposal Analysis

While it is possible that the property over the long term could generate more revenue than the $5 million offered by TCF, it is also possible that it could generate less. There are many variables that affect the likelihood of distributable revenues in any given year – the market for carbon credits, the market for timber, natural hazards such as fire and landslides that can destroy timber stocks and increase land management costs; and maintenance costs of roads and bridges. Revenues currently are derived from the sale of timber from the property and the sale of carbon credits. Carbon credits have been the major component of revenues, but the current cap and trade program is only authorized through 2030. Likewise timber values have gone up and down over the years TCF has owned the property, and timber sales are not expected to be a significant portion of property revenues in the near term, given the need to give the forest time to recover from past industrial harvests. There is no guarantee in any given year that there will be net revenues to distribute.

If TCF sells the property, proceeds from the sale would be distributed in accordance with the agreement. As TCF distributes net revenues and retires the obligations to the parties, the eventual net sales proceeds available to TCF, TNC and the Conservancy increases. However, the reality is that it may be challenging to find a private buyer for the Garcia River Forest property, given the constraints placed on the property by the conservation easement and the carbon project restrictions.

Given the uncertainties in property revenues and finding a private, for-profit buyer, staff recommends that the Conservancy accept TCF’s proposal to amend the revenue sharing agreement.

CEQA

The proposed amendment of the Conservancy’s revenue sharing agreement does not have the potential to result in a direct, or reasonably foreseeably indirect, physical change in the environment. Accordingly, the proposed amendment is not a “project” as defined under the California Environmental Quality Act (CEQA) and is not subject to CEQA.