Hill Top Lumber Company is considering building a sawmill in the state of Washington because the company doesn’t have such a facility to service its growing customer base that is located on the west coast. Hill Top’s executives believe that future growth in west coast customers will make the sawmill project a good investment. When evaluating the acceptability of the project, which of the following would not be considered a relevant cash flow that should be included when determining its initial investment outlay?

a. Hill Top owns acreage that is large enough and would be an ideal location for the sawmill. The land, which was purchased five years ago, has a current value of $3 million.

b. It is estimated that the cost of building the sawmill will be $175 million.

c. It will cost $3 million to clear the land on which Hill Top wants to build the sawmill.

d. It is estimated that $20 million of business from existing customers will move to the new sawmill.

e. All of these cash flows should be included in the computation of the sawmill’s initial investment outlay.

This is called an “externality effect.” Because these sales are not new (they shift within the firm), they are irrelevant. The other items represent marginal, thus relevant, costs that will be incurred by the firm. Answer a represents an opportunity cost because the land can be sold for $3 million if the firm does not use it for the sawmill—that is, the firm could generate $3 million from the land if it is sold.