



Timberland Report

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Pacific Northwest Timberlands: Transactions Slow, Attractiveness Remains

Timber markets in the Pacific Northwest have continued to decline, as evidenced by falling stumpage prices matched with growing mill curtailments, and slowing timberland transactions matched with leveling timberland investment returns. Still, forward looking investors see reasons for optimism. For instance, consider the impact of the Mountain Pine Beetle on the Canadian lumber producing industry. Any hole in future Canadian wood supplies creates an opportunity for accelerating the recovery of US-based producers when home builders renew their construction efforts.

TIMBERLAND TRANSACTIONS

Over 1 million acres have changed hands in the Pacific Northwest since 2007 (Table 1). Plum Creek Timber Company completed the 112,000-acre Phase Two of a three-phase sale to The Nature Conservancy and The Trust for Public Land in Montana. Phase Three is 70,000 acres scheduled to close in late 2009 or early 2010, wrapping up the 312,000-acre deal. Hancock Natural Resource Group sold 8,000 acres in Oregon to RMK this year and has an 18,500-acre property for sale in Washington. Other current timberland offerings include Rosboro Lumber's 11,400 acres in Oregon and two properties in Washington on the market from GMO (6,500 and 3,200 acres).

The RMK acquisition of the "Scapoose" property presents an interesting data point. This is a high-site property and pretty much a pure timber play. Moreover, it is small enough that it is quite liquid during a period when capital has tightened. We have seen several examples around the nation of above-average properties of small to medium size faring well in the market place – particularly in contrast to large offerings possessing average or below-average characteristics.

Table 1. Western timberland transactions since 2007

Year	Seller	State	Acres	Price/Acre	Buyer
2007	The Campbell Group	WA	140,000		Sierra Pacific Industries
2007	Sierra Pacific Industries	OR	43,000		Rosboro Pacific Northwest
2007	Potlach	OR	17,000	\$3,825	Greenwood Tree Farm Fund LP
2007	Massachusetts Pension Reserves Invest. Mgmt	OR	185,000	\$3,855	
2008	Cascade Timberlands LLC	OR	90,000		Trust for Public Lands
2008	Forest Capital Partners	OR	3,700	\$1,260	Union County, Oregon
2008	Green Diamond Resources	OR	114,000	\$3,000	Hancock Timber Resource Group
2008	Hampton Affiliates	WA	67,700	\$2,410	Longview Timber Holdings Corp
2008	Hancock Timber Resource Group	WA	32,100	\$2,810	Conservation Forestry
2008	Plum Creek Timber Company	MT	130,000	\$1,154	TNC, Trust for Public Lands
2008	Sierra Pacific Industries	WA	56,300	\$3,820	Rayonier
2008	Cascade Timberlands LLC	OR	25,700	\$450	Private Investors
2009	Plum Creek Timber Company	MT	112,000	\$2,232	TNC, Trust for Public Lands
2009	Plum Creek Timber Company	MT	70,000	\$1,271	TNC, Trust for Public Lands
2009	Hancock Natural Resources Group	OR	8,000	\$4,125	RMK Timberland Group
	Total		1,094,500		

Source: Forisk Consulting, Timber Mart-South

Based on public data, the number and size of timberland transactions have slowed and decreased over the past six to ten months. The timberland investment community seems to anticipate an adjustment in timberland prices as sellers probe the market for signals. An example of this trend in the region is the removal of 1.84 million acres in Louisiana, Oregon, Washington, and Idaho from the market by Forest Capital Partners in 2008.

MILL CAPACITY

Announcements of curtailments and closures in the Pacific Northwest have been increasing, which aligns with trends across the US (Figure 1). Although fourth-quarter curtailments are common in advance of holiday downtime and scheduled maintenance, they have increased in number since 2005 and have been actively extended into the first quarters in 2008 and 2009. Curtailment and closing announcements in the first quarter of 2009 increased nearly eight-fold from the announcements in the first quarter of 2005.

To put this shift into historical context, consider how total softwood lumber capacity in Oregon and Washington actually increased from 2002 to 2005 and then levelled off around 220 million cubic meters (129 billion board feet) from 2005 to 2007 (Figure 2). The number of mills declined from 2005 to 2007, in line with the curtailment and closure announcements. The combination of leveling capacity with an overall decrease in the number of mills supports a similar strong market signal from the US South, where smaller, older, and less efficient mills continue to shutter and industrial, high-volume mills add capacity and improve efficiency by spreading fixed costs over more units of production.

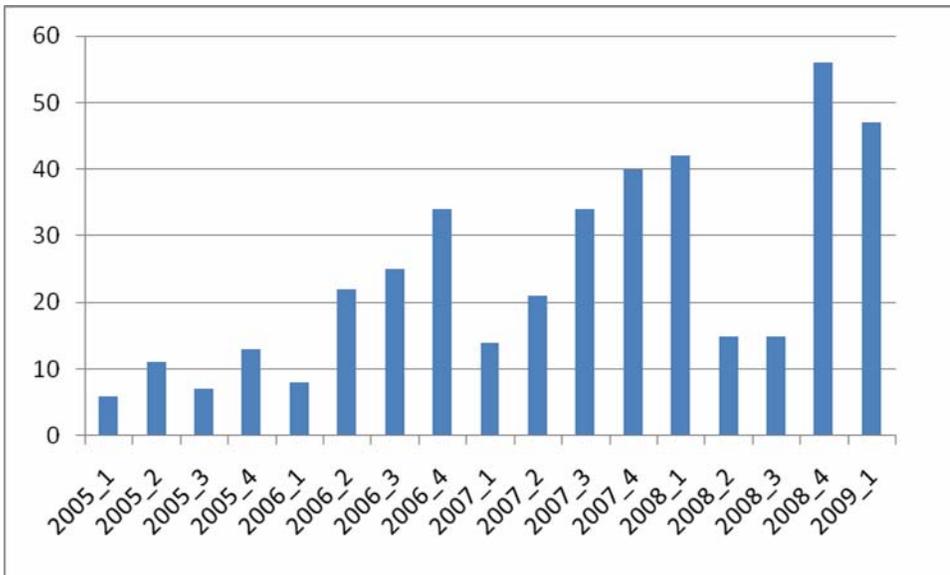


Figure 1. Number of U.S. mills with announced curtailments and closures
 Source: Random Lengths

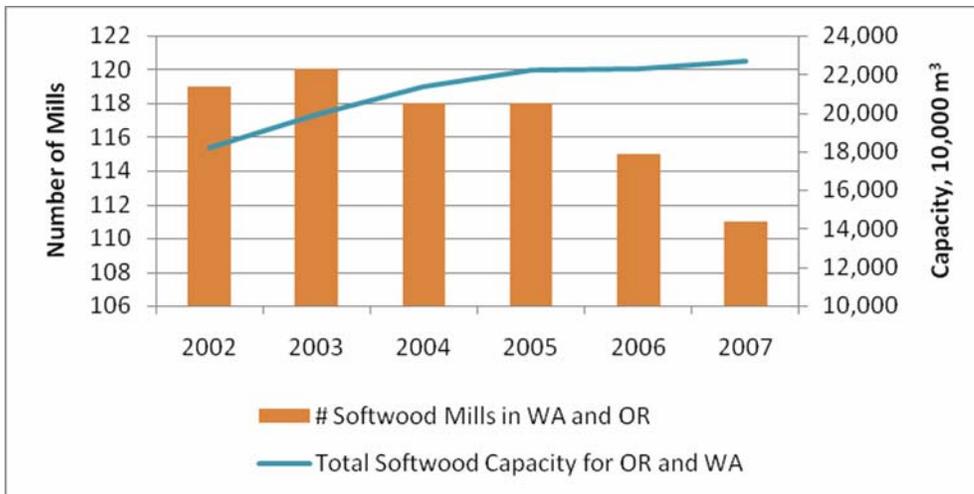


Figure 2. Capacity and Number of Softwood Lumber Mills, OR and WA
Source: Henry Spelter, USDA Forest Service

PRODUCT PRICES

Stumpage prices for Douglas-fir continued their downward trend since the 2002 peak of \$594 per MBF (Figure 3). Prices remained stable from 2006 to 2008, increasing by only 3% over two years to an average of \$408 per MBF in 2008. Prices dropped dramatically to \$330 per MBF in the first quarter of 2009, a 19% drop from the 2008 average, in response to the economic recession and near disappearance of domestic demand. Since 2006, Western hemlock prices in Washington have also been decreasing. Prices fell 14% from \$329 per MBF in 2006, to \$282 per MBF in 2008. In 1Q09 Western Hemlock prices fell to \$240 for a 17% decline from the 2008 average.

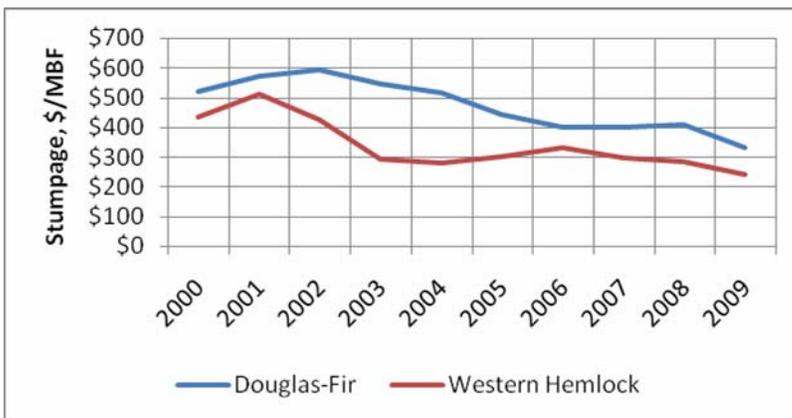


Figure 3. Stumpage Prices in Washington
Source: USFS

Delivered prices for Douglas-fir and Western Hemlock in Oregon climbed sharply in 2005 but have been decreasing ever since. Douglas-fir was \$667 per MBF in 2005 and dropped 28% to \$480 in 2008. The price dropped another 31% to \$333 per MBF in the first quarter of 2009. Likewise, Western Hemlock peaked in 2005 with a delivered price of \$443 per MBF. Prices declined by 17% to \$367 per MBF in 2008, and then fell to \$270 during the first quarter of 2009.

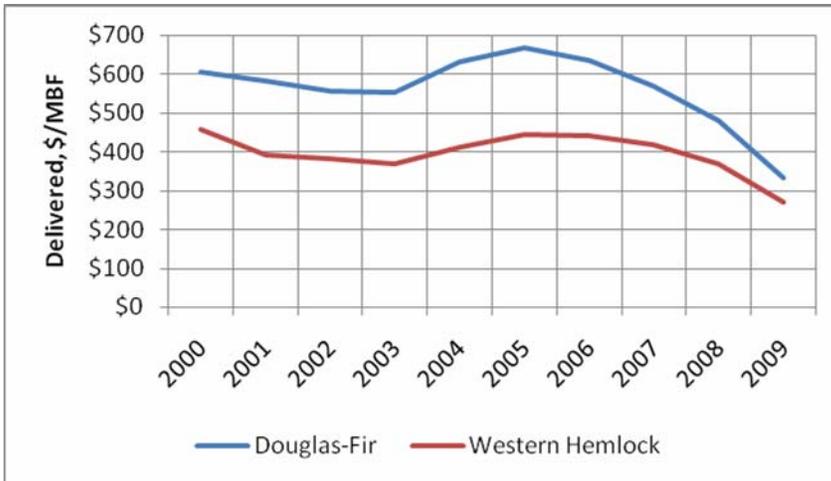


Figure 4. Delivered prices in Oregon
Source: USFS

The mountain pine beetle crisis in British Columbia provides some optimism for stumpage prices in the West. British Columbia's mountain pine beetle infestation will reduce timber supplies in the province over the next ten years. Estimates indicate that the afflicted lodgepole pine volume represents a loss of a fifth of the timber supply in the region. At least one plywood plant in the province closed as a result of the decreased supply, and many sawmills have complained of processing issues and decreased yields from processing dead timber.

British Columbia timber accounts for about 20% of the timber supply in North America.¹ A 20% decrease in supply in British Columbia would equate to a 4% decrease in North American supply. When harvesting in federal forests was severely curtailed in the early 1990s, in reaction to spotted owl concerns, softwood sawtimber stumpage prices in the U.S. South doubled in ten years. Based on this experience, we expect the pending reduction in supply from British Columbia to raise stumpage prices in the West and South once the housing market recovers.

TIMBERLAND RETURNS

The NCREIF Timberland Index for the West has outpaced that in other regions, including the Total Timberland Index (Figure 5). Although the Pacific Northwest comprises a smaller portion of the NCREIF Index by acres and value than other regions, its comparably large index values in relation to the South and Northeast pull up the value of the Total Timberland Index. The Pacific Northwest timberland index has 1.8 million acres (14% NCREIF acres) and a market value of \$5.6 million (23% of NCREIF value).

¹ Spelter, H., D. McKeever, and M. Alderman. *Profile 2007: Softwood Sawmills in the United States and Canada*. USDA Forest Service.

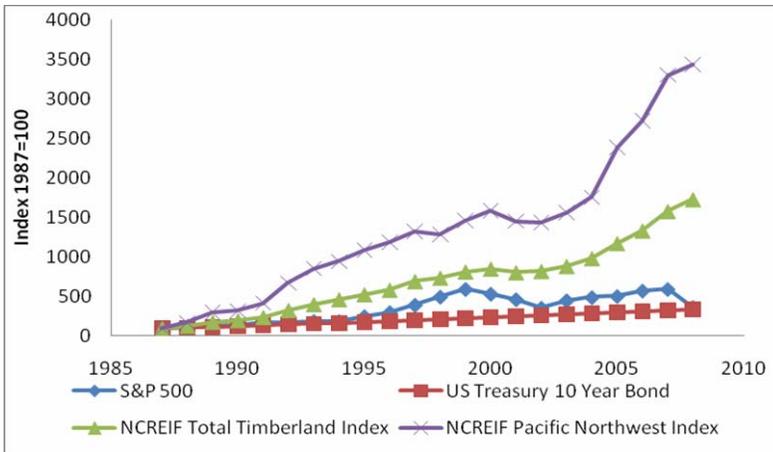


Figure 5. Relative performance of Pacific Northwest timberlands
 Source: NCREIF, US Federal Reserve, Yahoo! Finance

A look at the annualized timberland returns from all regions provides insight and supports a theory we mentioned in the Vol. 9 No. 1 issue of the Timberland Report: timberland returns across US regions are converging (Figure 6). The South has had the most stable returns and returns in the West have been decreasing. What are some reasons for this decrease? Stumpage prices—historically high in the West compared to other regions—have decreased in the past five years. In addition, the “low-hanging fruit” associated with the timberland investment sector has already been picked in the US. Early entrants to the timberland markets in the 1980s and 1990s captured, in effect, outsized returns during a period of lesser liquidity and transparency (during the divestiture of vertically integrated forest products companies). As the sector in the US has matured, we expect lower, more consistent returns moving forward from timberlands across all regions if land is changing hands from investor to investor. It appears that investors recognize this as well and are, one, waiting for a price adjustment to reflect the mature market and, two, valuing potential acquisitions in a way that reflects a return to forestry fundamentals and traditional recreation values. Until the general economy returns and the housing market with it, we don’t expect significant improvements in HBU markets. Meanwhile, forest owners are seeking “found money” from the energy sector in the form of biomass sales and wind energy leases.

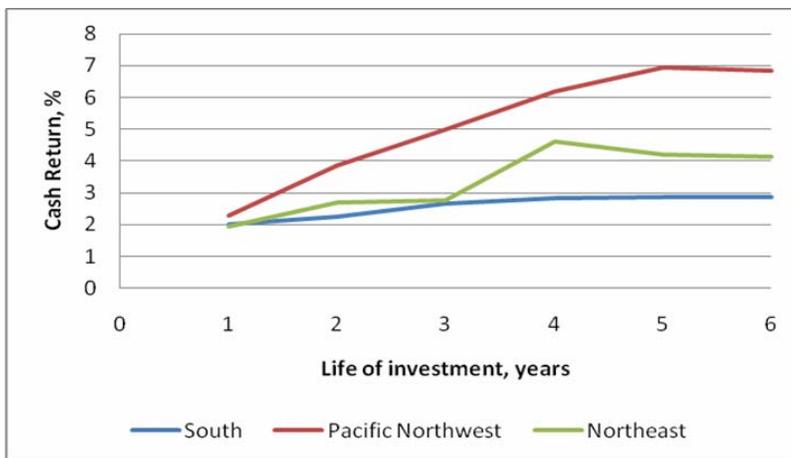


Figure 6. Annualized timberland returns for US regions
 Source: NCREIF

CONCLUSION

Timberland sale activity appears to have slowed in the Pacific Northwest with few large transactions and one large transaction pulled off the market in 2008. Investors appear to be waiting for a price adjustment, although some are still willing to aggressively pursue above-average, liquid forestland holdings. Mill curtailments and closures continue to increase in response to the economic slow-down, and stumpage prices have decreased for Douglas-fir and Western Hemlock in Washington and Oregon. Timberland returns indicate that returns in all regions are converging as the market matures. We expect lower, more consistent returns moving forward.

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