MADISON'S TIMBER PREVIEW

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The announcement last week of TimberWest's proposed sale to two large Canadian pension funds elicited a series of questions about the west coast timberland owner and erstwhile sawmill operator. A TimberWest spokesperson explained to *Madison's* that the company's corporate structure would change; it would no longer be publicly-traded, and there might be some changes on the executive level but company operations would remain the same. In particular TimberWest's ten-year plan to parcel and sell off real estate on Vancouver Island is still a go.

Concerned locals now understand that this proposed sale does not mean TimberWest's forest operations will cease, threatening their jobs. The boost in long term funding means the company doesn't have cash flow pressure when paying required dividends and due to debt load. Even more so now, TimberWest will operate as a US-style real estate investment trust (REIT).

To log or not to log? This question is perpetually on the minds of timberland owners, investors, and lumber producers with timberland holdings. Log prices have been rising steadily, especially on the west coast of the United States due to demand for Douglas fir logs from offshore buyers. Rising log prices result in increased value of timber, which makes timberland investment more lucrative. Despite continued depressed finished lumber prices, timber and log values are increasing as 2011 wears on.

In 4Q 2010, Douglas-fir log prices in the Northwest were up 19 per cent from the same quarter in 2009, according to *Wood Resources International*. Hemlock sawlog prices, which increasingly have been influenced by log exports to China and South Korea, have gone up over 25 per cent the past 12 months. With the recent price increases, sawmills on the west coast now have higher wood raw material costs than sawmills in the US south, which is opposite to the situation in 2009. Price levels in the southern states are currently close to their nadir of 15 years, says *WRI*. Sawlog prices in Canada have followed the same pattern as in the US, with prices in the Western provinces increasing more than in the Eastern provinces. In 4Q 2010, log prices in British Columbia had moved up to their highest levels in over two years in US dollar terms.

In addition, the paper and pulp sector is more steady than the volatile solid wood industry. Demand for timber for pulp and materials for paper production from Asia could have a significantly positive impact on the US forestry market going forward. Marshall Thomas, president of Alternative Asset Analysis, explained to PR-USA.net April 18 that this drive in demand "could have a positive impact on timber prices, both in the short and long term."

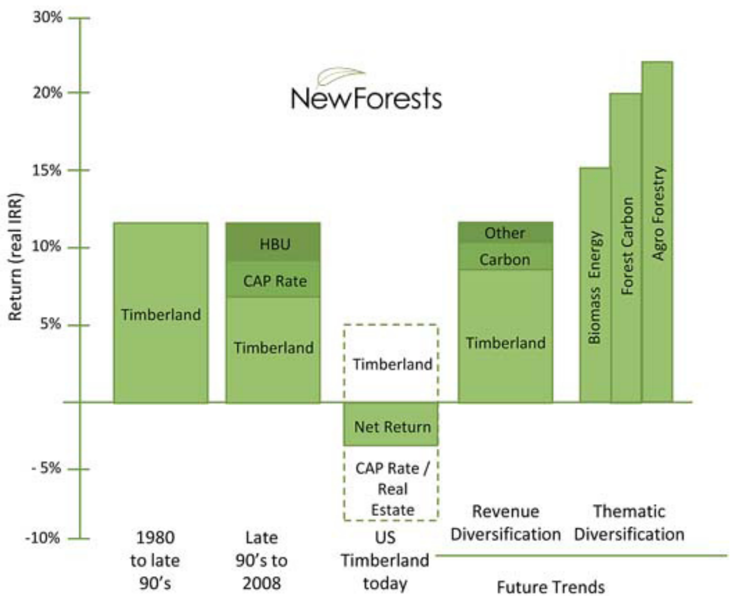
Fund management expert, Anthony Johnson, agreed in the same article, "Increased demand is likely to come from Japan, as it sets about the mammoth task of rebuilding whole regions after March's devastating earth quake and tsunami."

Other values are entering the timberland marketplace, apart from the land and the trees. So-called HBUs, or higher and better use, dominate the landscape of timberland investment conversations. Recreational uses, water filtration, carbon sequestration, even views, are increasingly playing into timberland appraisals.

"The HBU potential for timberland may act as a longer term 'call option', for which investors may pay very little at the date of purchase," explains a Meketa Investment Group white paper.

Curtis Seltzer of *LandThink* explains it this way, "Timberland today often appears to be priced with, perhaps, 75 per cent of property value presumed to be in the dirt (a large portion of which is thought to be HBU value) and the remainder is the timber value. [. . .] If the seller thinks the merchantable timber is worth US$200/acre, the property might be priced for sale at US$800/acre."

Or as Tom Tuchmann is president of US Forest Capital, put it to the *Chinook Observer* April 5, "Job number one is keeping large ownerships working so that the carbon, biodiversity, water quality and fibre production engine is protected. Environmental markets – like carbon – that provide incentives to landowners to continue to manage forests can play an important part in financing working forests, but prices will have to increase significantly to be used at scale. [. . .] With 84 per cent of the US's industrial timberland having been sold over the last 15 years, there is a strong likelihood that we will see another round of timberland sales in the future. Whereas, integrated companies sold their properties in hundred of thousands to million-acre chunks, for example International Paper sold 4 million acres in one auction, the next wave is likely to see a greater number of sales in smaller parcels of tens to hundreds of thousands of acres."



As another example, Campbell Group out of Portland, OR, is one of the largest timber investment management organizations (TIMO) in the world, managing 3 million acres of timberland for investors. 140,000 acres of Clatsop County, WA, timberland, was sold from Crown-Zellerbach to Cavenham Forest Industries, who later sold it to Hancock Lumber, who sold it to Willamette Industries in 1996. Weyerhaeuser grabbed it in a hostile takeover in 2002 and sold it to Campbell Group in 2010. The company did not purchase Weyerhaeuser's Warrenton, WA, sawmill but logging continues on Campbell Group land much like it has under previous ownerships.

In this, the International Year of the Forests, the UN estimates that financial flows for greenhouse-gas-emission reductions from REDD could reach up to US$30 billion a year globally.

Mercer Consulting released a study in February titled "*Climate Change Scenarios – Implications for Strategic Asset Allocation*", asserting that institutional investors could lose trillions of dollars over the coming decades as a result of "continued delay in climate change policy action and lack of international coordination."

Opportunities, the report said, lie in an increased allocation to infrastructure, real estate, private equity, agriculture land, timberland and sustainable assets, with investment opportunities in low carbon technology reaching up to US$5 trillion by 2030.

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