

MADISON'S LUMBER REPORTER


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News & Updates

Madison's Timber Preview: US Foreclosure Freeze

Recent revelations that some US banks and mortgage lenders have been processing foreclosure and eviction documents without proper documentation have thrown US congressional representatives and the courts into a tizzy. Already three of the largest holders of mortgages have stopped foreclosure proceedings while they check their staff's paperwork.

This week's issue of *Madison's Timber Preview* examines the changes already put into place and looks at some possible outcomes of this new US mortgage crisis.

Contact us any time for a subscription.

US Requests Canadian Softwood Lumber Consultation

As the British Columbian forest industry has long known, the Coalition has been preparing a claim against BC lumber imports into the US. At issue is the increased harvest of mountain pine beetle killed timber, and the reduced stumpage to incentive processing of recently dead wood into lumber before the quality degrades too much.

The US government delivered a formal request for consultation to the Canadian government Friday. [READ MORE](#)

Housing Starts, Canada

September Canadian housing starts fell by 1.5 per cent compared to August, which was less than expected, to 186,400 units said the Canada Mortgage and Housing Corp Friday. Single family home building dropped by 8.1 per cent to 63,600 seasonally adjusted units, while multi-unit dwelling remained unchanged from August at 99,600 units.

Japan Housing Starts and New Wood Building Law

Total housing starts in Japan for August were up 20.5 per cent over August 2009, to 71,972 units, according to the *Japan Lumber Reports*. August 2009 Japan housing starts were down 40 per cent over the same month in 2008. It is the first time in 19 months that starts were over 70,000 units and the third consecutive month of increases. Seasonally adjusted monthly starts were 829,000 units, a 7.4 per cent increase over July.

Condominium starts increased by 44 per cent in August, while owner's starts held steady with ten straight months' recovery. 2x4 homes increased by 7 per cent and traditional post and beam units were up by 7.8 per cent. [READ MORE](#)

Timberland Value and Log Price Projections

The always hot topics of timberland investment, timber values and log prices were much discussed at *Who Will Own the Forest 6?* at the World Forestry Center in Portland, OR, September 20 to 22. Experts and analysts of all stripes weighed in with data and analyses of what happened to timberland values in the past few years and what reasonable expectations can be for the next five years.

Most interesting was a change to the method of valuation, it is now normal to include factors such as water, wind power, biomass and even scenic quality into timberland appraisals. [READ MORE](#)

JAPANESE HOUSING STARTS

Month	TOTAL	Non-Wood	Wood	%Wood
Aug-10	71,972	29,899	42,073	58
Jul-10	68,785	28,740	40,045	58
Jun-10	68,688	27,940	40,748	59
May-10	59,911	24,952	34,959	58
Apr-10	66,568	32,143	34,425	52
Mar-10	65,008	31,061	33,947	52
Feb-10	56,527	24,412	32,115	57
Jan-10	64,951	30,322	34,629	53
Dec-09	69,298	28,643	40,655	59
Nov-09	68,198	27,416	40,782	60
Oct-09	67,120	28,175	38,945	58
Sep-09	61,181	24,771	36,410	60

Source: Japan Wood-Products Information and Research Center

CANADIAN HOUSING STARTS

Actual and Seasonally Adjusted Annual Rates

	September 2010		August 2010	
	Actual	SAAR	Actual	SAAR
Canada, all areas	16,929	186,400	16,509	189,300
urban ctrs with >10,000	14,401	163,200	14,253	168,800
singles, urban centres	5,963	63,600	6,123	68,200
multiples, urban centres	8,438	99,600	8,130	99,600
rural areas	2,528	23,200	2,256	20,500
Atlantic urban centres	720	7,400	847	9,700
Quebec urban centres	3,623	42,400	2,822	40,800
Ontario urban centres	4,885	54,500	5,524	61,200
Prairie urban centres	2,868	32,400	2,807	32,200
B.C. urban centres	2,305	26,500	2,253	24,900

Source: Canada Mortgage and Housing Corporation

Key Prices

	This Week	Last Week	Change	Month Ago	Change	Year Ago	Change
WSPF KD R/L 2x4	233	235	-2	231	+2	180	+53
WSPF KD R/L 2x6	247	248	-1	243	+4	190	+57
WSPF KD R/L 2x8	276	279	-3	277	-1	215	+61
WSPF KD R/L 2x10	315	318	-3	316	-1	315	0
WSPF KD PET 2x4 Stud	200	200	0	210	-10	190	+10
Douglas Fir Green R/L 2x4	180	180	0	200	-20	155	+25
Douglas Fir Green R/L 2x10	260	250	+10	258	+2	210	+50
ESPF KD 2x4 8ft Stud	280	285	-5	275	+5	275	+5
OSB Ontario 7/16" (CDN\$)	210	210	0	210	0	185	+25

Weekly News

2006 Softwood Lumber Agreement

CONTINUED United States

Trade Representative Ron Kirk announced Friday that the US has requested consultations with Canada under the 2006 Softwood Lumber Agreement regarding the apparent unfair under-pricing of timber harvested from public lands in the Interior region of British Columbia.

At issue are BC's practices that have led to a dramatic reduction of stumpage costs for BC Interior lumber producers through a massive increase in the share of logs classified as "Grade 4" and therefore stumpage rate of C\$0.25 cents per cubic metre, says a Friday press release out of the US Coalition for Fair Lumber Imports.

"Since the spring of 2007, the BC Government has sold enormous amounts of timber to Interior lumber producers for the minimum price of C\$0.25 per cubic metre contrary to the rules governing eligibility for minimum stumpage prices that are grandfathered under the SLA," says a USTR fact sheet obtained by *Madison's Lumber Reporter*.

"It is very disappointing that President Obama is talking about pulling down trade barriers, yet the US administration is entering into an arbitration over something that is clearly grandfathered into the 2006 SLA," BC's Minister of Forests and Range, and Integrated Land Management, Pat Bell told *Madison's* in a phone interview.

"BC has not changed any of its harvest practices since the signing of the SLA. It is no big secret that the longer the beetle kill timber is dead the less suitable it is for lumber purposes. Forest companies in BC are doing the best they can with a very poor log grade," continued Bell.

"The US lumber industry is not competitive, there has been little investment

in mills, they are not current, and they can't compete with world class mills," Bell charged back at the US Coalition for Fair Lumber Imports.

Zoltan van Heyningen, spokesperson for the Coalition, explained to *Madison's* Friday, "We anticipate that the arbitration process will be executed. If the 40 day consultation period between the US and Canada as set down by the 2006 SLA does not see resolution we fully expect arbitration to proceed expeditiously."

When asked about statements from some BC forest agency representatives that this claim is politically motivated in the face of US mid-term elections this November, van Heyningen said, "The idea that this is a political move is ridiculous. The US is not of the same point of view as BC that practices currently engaged in with Grade 4 logs is grandfathered into the 2006 SLA. US Trade Representative Kirk is simply making sure that international trade agreements are enforced. This is not protectionism."

The 40 day consultation period expires November 17. *Madison's* has faint hope of a resolution coming out of that consultation period, or this claim would frankly not have been made in the first place.

van Heyningen has indicated to *Madison's* that a formal SLA arbitration will likely be launched by the US against Canada before the end of 2010.

Japan Wood Building Policy

CONTINUED August wood based units built increased by 21 per cent over August 2009, to 42,073, comprising 58.5 of total units built says the *Japan Lumber Reports*.

August building permits were also up, by 19.3 per cent over August 2009, to 48,628.

The unrolling of Japan's Forestry Agency's push to increase the use of wood in all building got more encouragement from five groups of wood importers, according to the *Japan Lumber Reports*. At issue is the Forestry Agency's previous focus on domestic wood products.

The importers maintain that Japan's domestic forest industry is not big enough to support a proper move to wider use of wood, and the wording of the Agency's statement should be changed to a target of 50 per cent utilization for both building materials like lumber and plywood, and pulp and chips. The Agency had previously announced a target of 60 per cent for wood building but of domestic products, and only 39 per cent for pulp and wood chips, says the *Reports*.

BC's New Wildfire Management Policy

As first announced in the September 24 issue of your *Madison's Lumber Reporter*, the British Columbia Ministry of Forests and Range will be re-examining BC's wildfire strategy in the face of 2010 forest fire activity.

Madison's managed to track down the very busy Minister responsible, Pat Bell, to find out what this new strategy will mean in terms of the harvest.

"We are going to incorporate planning for fires into forest stewardship plans for the first time," Bell told *Madison's* in a phone interview late Thursday. "There will be planning for cut blocks in consideration of forest fire management."

Planning tools will be in place for harvesting practices for 2011, and changes will be rolled out over time. By the end of this year the BC forest industry will start seeing new instructions, said Bell.

"We had to re-think our planning after the large complex fires of 2010. We found that a series of small fires can grow together using wildlife corridors, riparian areas, and old growth management, to combine into one large fire," explained Bell.

Log Prices and Timberland Values Changes to Traditional Model

Those using timberland as an investment tool, whether investors or analysts, understand that the main driver for the value of timberland is log prices.

by Kéta Kosman

Log demand drops when the lumber market is depressed, so timberland owners look at forecasts to determine when to plan the next timber harvest, or if they should simply let the trees grow for another couple of years thereby increasing the value of their investment. Until very recently lumber production and log demand was essentially all timberland owners needed to look at, but increasingly factors like watershed health, easements, higher and better use, biomass fuel, and carbon credits are coming into play when valuing timberland, both in the US and globally.

The sixth annual *Who Will Own the Forest?* conference at the World Forestry Center in Portland, OR, on September 20 to 22, 2010 brought fascinating presentations and discussion on this expanded model for valuing timberland around the world. While some speakers focussed on specific issues like hardwood plantations in Africa, pulp-grade Eucalyptus in Brazil and New Zealand, or navigating the new legalities of environmental and energy issues in the US, the most popular – and debated – speeches covered what the future holds for timberland investors.

As moderator for *Session 3: Appraising Valuations*, Dennis Neilson of DANA, Ltd. out of New Zealand offered useful summaries and pertinent questions. This is now the third time *Madison's* has encountered Neilson at such events, and is always impressed with both his grasp of the subject matter and his ability to deliver information effectively (despite a thick New Zealand accent and speaking very quickly indeed). As Director of DANA, Neilson consults on timberland investments, appraisals, strategic planning, and international wood products trade to a number of international companies.

“Transactional evidence (on timberland sales) in the US are generally measured in dollars per acre, with Australian and New Zealand transaction evidence often converted to an Implied Discount Rate, or Discounted Cash Flow, for the purposes of a cross-check of a Net Present Value calculation,” detailed Neilson at super-sonic speed.

What this means is that log prices are but one factor in valuing timberland in

New Zealand; discount rate is important, and treatment of the land, as well as treatment of secondary and more timber rotations. In addition, explained Neilson, New Zealand has now legislated an emissions trading scheme involving trees, essentially a carbon offset.

“We employ quite a range of methodologies, taking into account averages of the last eight, 12, or even 20 quarters,” concluded Neilson, miraculously not yet out of breath. “We were betting on a regression to the mean.”

That bet turned out to be a good one and DANA, Ltd. continues in excellent standing for its log market and timberland value analyses.

Next, Whit Hill, of John Hancock Bond and Corporate Finance, tackled the subject of *A Lender's Perspective on the Credit Environment*. Managing Director of Hancock's Investment Sector, Hill is a member of the Natural Resources Team, which is responsible for a US\$9.4 billion portfolio in oil and gas, timber, paper, forest products, building materials and homebuilding companies worldwide.

After explaining recent developments in the credit market generally, Hill moved on to timberland credit specifically.

“In terms of outlook, the positives for US timberland economics are; residential construction will recover, the interior BC timber harvest will decline, and export markets are improving,” began Hill. “Lingering difficult conditions include; weak economic fundamentals hinder cash generation, and valuation and asset liquidity remain a concern.”

Regardless, concluded Hill, timberland remains an outstanding vehicle for fixed income investment, the interest rate environment is favourable, and the long term fundamentals are positive.

The next speaker, Rick La Mont, President of Timberland Appraisal Inc, analyzed US timberland value beyond log prices. With 25 years' experience in valuing billions of dollars in timberland in the US and overseas, La Mont is a leading consulting authority on the supply of the world's timber resources and in the design of complex timber inventory management programs.

Using a telling graph, La Mont's data shows that, given the trend over the past 40 years, real log prices in all species across the US are currently well below where the average should be. Log prices dropped from a high of just under US\$1,100 in 1994 to less than US\$500 Scribner's scale in 2010. Log prices have fallen by an average of 4.95 per cent from 2000 to 2010.

Using a Return to Trend Forecast, and keeping the log price cycle of the 1980's

well in mind, La Mont's data shows log prices rising to close to US\$700 Scribner's scale by 2015.

Getting to the much-discussed topic of assessing the land value, La Mont explained, “In terms of allocated values, it is necessary to compute the timber value and the residual land value. Timberland appraisers determine bare land value, which is usually only 10 to 15 per cent of total timberland value. Site and soil productivity analysis is based on Faustmann's formula. Large properties use the Discounted Cash Flow while smaller properties require a Higher and Better Use analysis.”

Regarding Higher and Better Use, and non-timber values, La Mont asks the question, ‘Is there a market for this?’ One thing making it difficult for analysts to factor in these new criteria is the lack of sizable timberland sale transactions in the past few years, so one and all were qualifying their projections by saying that only once a few large parcels of timberland start changing hands again will proof be available.

“Non timber revenues include communications sites (cell phone towers), mineral rights for water, gravel or gas, wind energy, and biomass,” said La Mont. “There is already a marketplace for these. As far as carbon is concerned it's too early to tell yet.”

Finally, Bret Vicary, VP of Forestry and Natural Resource Consulting for James W. Sewell Company, went into a detailed explanation of timberland appraisals in the US northeast.

“In the US northeast multiple-use opportunities abound,” indicated Vicary, echoing La Mont. “Wind, biomass, ethanol, carbon equity, even scenic values are added to basic timber values and log pricing. These are non-subsidized marketplaces. The preservationist momentum is gaining strength, as large working forest conservation easements comprised 1.7 million of 2.0 million acres under easement as of February 2010.”

In Sewall's 2Q 2010 investor survey, responders indicated that Canada's mixed forest had by far the lowest risk premia over US forestland. Defined as ‘the expected excess return on a security or portfolio, where excess return is the difference between an actual return and that of a riskless security’, earning risk premia means ‘there may be large, infrequent losses from bearing certain risk factors, resulting in a short-option-like return distribution, but the returns over time are sufficient to make the activity profitable.’ On Sewall's investor survey Mozambique's plantation forests rated as the highest risk premia, Costa Rica's teak forest and eastern Europe were in the middle, and New Zealand's pine forests rated lowest next to Canada.