

MADISON'S LUMBER REPORTER

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News & Updates

Madison's Timber Preview

This week's issue of *Madison's Timber Preview* examines the latest moves by Conifex Timber, including a new deal to purchase the lumber sales business of Welco Lumber and the transportation and logistics operations of Navcor Transportation Services, both long-standing contracts of Conifex.

Contact us any time for a subscription.

Canada Building Permits, International Trade

The value of Canadian building permits jumped by 6.3 per cent to \$7 billion in July, matching a record set in May, 2007, Statistics Canada said Thursday.

Residential permits rose by 14.6 per cent to \$4.3 billion, the third consecutive monthly gain, on an increase in multiple-family dwellings. Much of the strength was accounted for by Ontario.

Non-residential permits slipped by 4.5 per cent to \$2.7 billion on a 40.1 per-cent drop in the value of the industrial component. The overall value of all permits was 11.6 per cent higher than in July, 2010. [READ MORE](#)

Wildfires Continue

A 20 hectare fire near Kelowna, BC, which forced the evacuation of 550 homes, was extinguished earlier this week.

Meanwhile stubborn fires continue to rage across drought-stricken Texas. Some 1,386 homes have been destroyed over 34,038 acres in the Bastrop County Complex fire. County officials said the nearly 850 firefighters battling a blaze near Austin continue to make progress in containing the historic fire.

As of Thursday the fire was more than 30 per cent contained. [READ MORE](#)

Japan Housing Starts

New home building in Japan rose considerably in July, according to the *Japan Lumber Reports*. Total housing starts were 83,398 units, a 21.2 per cent increase over one year ago.

Seasonally adjusted starts were at 955,000, a 16.9 per cent increase over June and the highest level since December 2008.

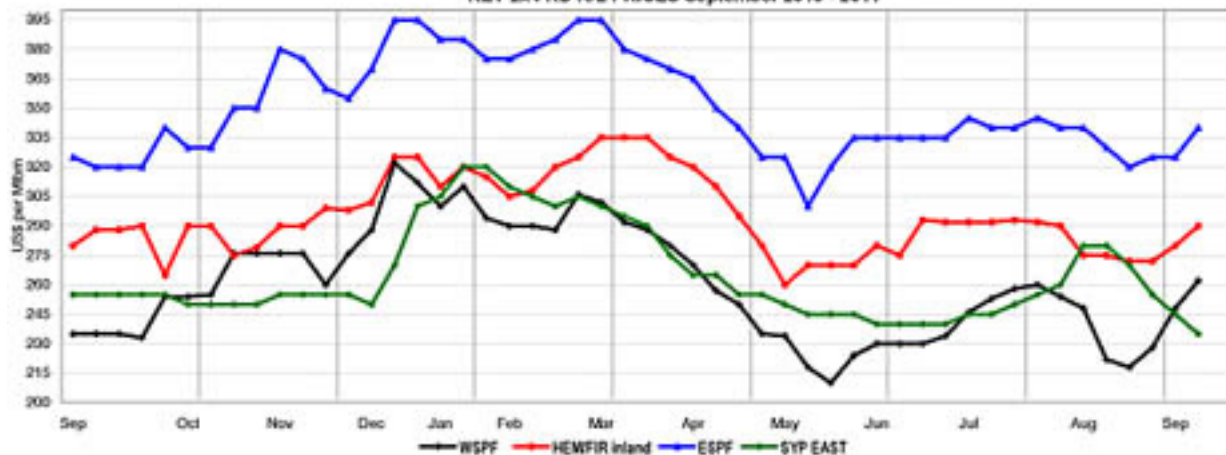
Construction interrupted by the East Japan earthquake in March has finally resumed at normal levels as builders rushed to meet the government-sponsored housing eco point system, which expired on July 31. [READ MORE](#)

Softwood Lumber Arbitration Witness Report

The expert witness report of San Francisco, CA's Jonathan Neuberger, principal at Economists Incorporated, expanding on the US claim against Canada under the 2006 Softwood Lumber Agreement was released to the public this week.

In 91 pages Neuberger breaks down British Columbia's timber pricing system, offering analysis, examination of data, and assessments to back up the US claim of Canada's alleged breaches under the SLA. [READ MORE](#)

KEY 2x4 KD R/L PRICES September 2010 - 2011



Data Digest: a weekly summary of economic news by the Associated General Contractors of America

“The multifamily housing market continued to show improvement in 2Q 2011, as the **Multifamily Production Index**...increased for the fourth consecutive quarter,” the National Association of Home Builders, which compiles the MPI, reported on Thursday. “The MPI rose from 41.7 in 1Q of the year to 44.4 in 2Q. It is the highest quarterly reading since 2006, and continues the trend of generally improving conditions in the market for new multifamily housing that has emerged since the MPI dropped to a record low of 16 in 3Q 2008. The index and all of its components are scaled so that any number over 50 indicates that more respondents report conditions are improving than report conditions are getting worse. In 2Q 2011, a majority of developers saw improvements in the production of low-rent and market-rate units.

‘Multifamily rental construction is trending upward, and it is definitely the brightest sector in the broader housing market,’ said NAHB Chief Economist David Crowe. Looking forward, developers’ expectations about multifamily construction for the next six months improved in 2Q in all three market components: low-rent, market-rate-rent and for-sale multifamily....‘Even though multifamily is trending upward, production is still very low in a historic context,’ Crowe said.”

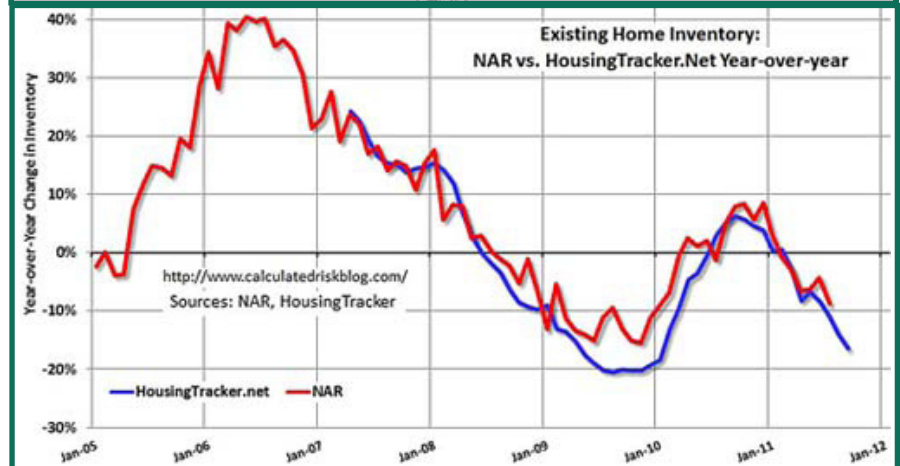
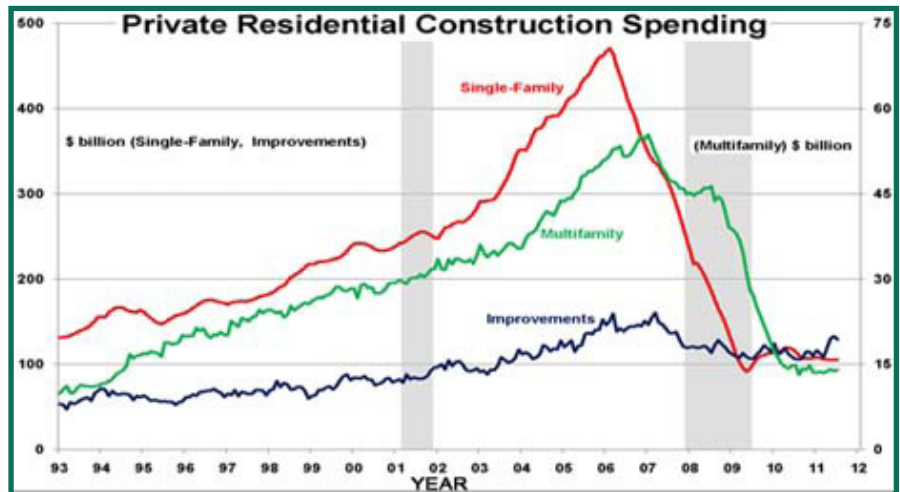
US Housing Inventory

HousingTracker reported that the early September listings – for the 54 metro areas – declined 16.5 per cent from last September. Of course there is a large percentage of distressed inventory, and various categories of “shadow inventory” too. But this is a significant year-over-year decline and pretty soon we will be talking about inventory being at the lowest level since 2005.

US home prices increased by 4 per cent in the latest rolling quarter according to **Clear Capital’s Home Data Index (HDI)**, but the growth rate shows signs of slowing as the summer buying season ends and eroding consumer confidence could make for a bumpy ride for the rest of the year.

All four regions of the US posted quarterly gains for the second consecutive month with the largest price gains posted in the Midwest (7.3 per cent), followed by the Northeast (4.9 per cent), the South (3.5 per cent), and the West (0.7 per cent).

All four regions continued to post year-over-year declines with the Midwest suffering the largest decline of 9.8 per cent followed by the West (-6.9 per cent), the South (-5.7 per cent), and the Northeast (-2 per cent).



Prices are in U.S. dollars per 1,000 fbm.

Key Prices

	This Week	Last Week	Change	Month Ago	Change	Year Ago	Change
WSPF KD R/L 2x4	262	248	+14	222	+40	231	+31
WSPF KD R/L 2x6	272	264	+8	252	+20	243	+29
WSPF KD R/L 2x8	285	282	+3	275	+10	277	+8
WSPF KD R/L 2x10	285	282	+3	282	+3	316	-31
WSPF KD PET 2x4 Stud	260	250	+10	220	+40	210	+50
Douglas Fir Green R/L 2x4	252	240	+12	250	+2	200	+52
Douglas Fir Green R/L 2x10	285	290	-5	300	-15	258	+27
ESPF KD 2x4 8ft Stud	320	315	+5	320	0	275	+45
OSB Ontario 7/16" (CDN\$)	210	210	0	205	+5	210	0

Weekly News



Building Permits, Trade, Canada

CONTINUED A separate report from Statistics Canada revealed that new house prices continued to edge higher in July.

The agency's New Housing Price Index rose 0.1 per cent in July, following a 0.3 per cent advance in June. The metropolitan region of Toronto and Oshawa was the top contributor to the increase in July.

In other news, Canada's merchandise exports rose 2.2 per cent and imports edged up 0.5 per cent in July. As a result, Canada's trade deficit with the world narrowed from \$1.4 billion in June to \$753 million in July.

Exports increased to \$37.3 billion, as volumes rose in most sectors. Overall, volumes rose 4.1 per cent, while prices declined 1.9 per cent. Machinery and equipment, automotive products, and industrial goods and materials were the main contributors to the gain in the value of exports.

Imports grew slightly to \$38 billion as prices increased 0.9 per cent and volumes decreased 0.4 per cent. In July, imports from Japan surpassed \$800 million, a level similar to those observed prior to the earthquake and tsunami in March.

More Wildfires

CONTINUED More than 3.6 million acres in Texas have been scorched by wildfires since November, fed by a continuing drought that has caused in excess

of US\$5 billion in damage to the state's agricultural industry and that shows no sign of easing.

In the past seven days the Texas Forest Service has responded to 186 fires burning some 156,517 acres across the state.

Firefighters are battling massive blazes in Montgomery County, north of Houston, and Cass County, northeast of Dallas near Texarkana.

The Houston-area blaze has scorched more than 15,000 acres and destroyed 75 homes. It is about 60 per cent contained, according to the Texas Forest Service.

The Bear Creek fire in northeast Texas has burned anywhere from 25,000 to 40,000 acres, and state forest officials did not have a containment figure on Friday morning.

Elsewhere, heavy smoke hung in the air Friday over Goldendale, in Washington State, where a wildfire has charred more than 8 square miles, or 5,300 acres, and forced the evacuation of about 75 homes.

Washington is experiencing an especially late start to its fire season following a winter with heavy snows and a cool spring.

On the Olympic Peninsula, fire managers on Friday expect that they'll be able to contain a wildfire that started August 31 in a wilderness area near Brinnon.

In Montana numerous wildfires ringing the Bitterroot Valley are being coaxed on by a stubborn high-pressure system that has brought unseasonably warm temperatures and low humidity levels, prompting local health officials to urge residents to be aware of the air they breathe.

The 4,558-acre Up Top fire continued to burn actively on both sides of the Skalkaho Highway in Montana on Thursday.

Housing Starts, Japan

CONTINUED Japan's new owner's unit starts in July were 32,382 which is the highest level in almost three years, says the *Reports*.

Rental units also reached a record high of the past two and a half years, at 30,464 units. Condominium building continued as the largest type of new construction in Japan with a 79.6 per cent increase compared to one year ago.

New wood-based units rose by 20.3 per cent, with a 55.7 per cent share of all new construction.

Ainsworth Lumber Management Change

Ainsworth Lumber Co. Friday announced the appointment of Jim Lake, currently VP, Operations as President and COO, after President and CEO Richard Huff announced his retirement today.

Lake would report directly to the board of directors.

Jim Lake joined Ainsworth in June 2010 and since that time has led a significant improvement in operating performance at the Company's mills. When he joined the Company, he brought over 25 years of industry experience having held the position of VP Operations at Grant Forest Products and prior to that, VP Manufacturing at Louisiana Pacific Corp.

Softwood Lumber Arbitration

Expert Witness

It was with trepidation that Madison's this week opened the newly-released expert witness report to the latest US-launched arbitration under the 2006 Softwood Lumber Agreement by Jonathan Neuberger of San Francisco, CA-based Economists Incorporated. The 91 page document explains the current US claim against Canada, specifically in terms of British Columbia's timber harvest practices. Reading through the details, *Madison's* understood that Canada must draft an equally strong defense. Without such a detailed written case in its favour, the lumber producers of BC that ship into the US will most likely be paying the extremely punitive additional duty requested by the US in its Statement of Case.

Please refer to the August 26 issue of your *Madison's Lumber Reporter* for a summary of the US claim.

As explained in our previous coverage of this subject, the US claims that alleged changes to the BC timber pricing system in spring 2007 are not grandfathered into the SLA. The scope of these allegations are expanded upon in Neuberger's report. The full report can be found on the Office of the US Trade Representative's website here http://www.ustr.gov/webfm_send/3054

In that report released this week, Neuberger states in his Summary of Opinions on page 4, "I considered the possibility that the increase in Grade 4 was largely due to the MPB epidemic. I found evidence of significant misgrading even after considering the effect of the MPB epidemic. [. . .] any loss in the quantity and value of lumber caused by the MPB is not large enough to explain the significant increases in the amount of logs assigned to Grade 4."

Neuberger found that in the first year of the new grading system, put into place in April 2006 and grandfathered into the SLA, the actual average share of logs assigned to Grade 4 was 17.8 per cent. Neuberger deems this to be a "reasonable benchmark". Referencing BC government data on the timber harvest and stumpage rates, Neuberger found that after the grading change in spring 2007, "the volume of Grade 4 logs rose first into the 20-35 per cent range for the remainder of 2007, then into the 35-60 per cent range for 2008, peaking at almost 66 per cent in 2009, before falling slightly in 2010."

On Page 28 Neuberger points out, "The relevant question is what caused the Grade 4 percentage eligible for the C\$0.25 rate under the new grading system to rise over the next three years to virtually the same level as the combined Grades 3/4/5 percentage (that also received the C\$0.25 rate) under the old grading system."

On the Canadian side, both federal and British Columbian provincial politicians have repeatedly stated that the rate of harvest for Grade 4, or beetle-kill, timber has increased because there is a need to remove as much of the dead trees before the wood degrades beyond use for merchantable lumber.

In response to Canada's defense, the Office of the US Trade Representative states that a huge proportion of this discounted-stumpage timber was indeed used for merchantable lumber, therefore charging the salvage rate of C\$0.25 amounts to a government subsidy to BC lumber producers.

Citing four mill studies carried out by Forintek in 2007/2008, Neuberger maintains there was misgrading of logs as Grade 4 because, "if lumber recovery and value were significantly lower in Grade 4 logs, the Prince George test should indicate a much higher grey-stage loss than the Quesnel test."

The response to the US Claim from Canada so far has been that sawmills in the worst of the pine beetle-devastated areas have upgraded equipment and processing in order to make better use of dry, grey, beetle-kill logs. It seems the brunt of the US claim relies on data which indicates that, in those circumstances, the logs did not meet the 50/50 rule and should not have been valued at the \$0.25 salvage rates.

Neuberger next cites a later study by a private company updating the Forintek data, which found "the merchantable shares of the lumber produced at different attack levels were: green no attack, 87 per cent; four-year grey-attack, 80 per cent; eight-year grey-attack, 73 per cent, and 12-year grey-attack, 67 per cent." Neuberger comes to the conclusion that "These relatively small decreases in lumber recovery and lumber grade recovery factors, reflecting significant shelf-life of MPB logs, are inconsistent with a multi-fold increase in Grade 4 starting in early 2007."

Neuberger's assessments are flawed when it comes to the lumber market. On page 25 he goes into some detail on lumber shipments and prices, and the narrowing difference between the price of WSPF KD 2x4 #2&Btr and #3/Utility. Using a regression with the natural logarithm, Neuberger claims that "The coeffi-

cient for the share of exports that went to China was statistically insignificant, and the coefficient on the time trend variable was statistically significant and negative, which indicates that even after holding constant the effect of increased demand from China, this price spread was declining."

This is too simplistic an assessment. In 2008 the volume of BC lumber shipments to China could be considered 'statistically insignificant' when compared to its shipments to the US, especially in view of exponentially-rising 2011 export volumes to China. However the realities of establishing a new market and customer base can not be ignored. Certainly BC producers, faced with the steady decline of demand from the US, would have offered deals and temporary discounts on the first shipments of wood going to China. It is only lumber shipments going from Canada to the US that are subject to and monitored under the SLA. There are market factors at play beyond simple export figures which should not be ignored.

Another potentially conflicted aspect of Neuberger's report is the comparison between BC and Alberta of the average unit value of exports of lumber to the US. It will be interesting to see what reasoning the Canadian side will use to refute Neuberger's statement that "the value of lumber from BC did not decline relative to the value of lumber from Alberta, consistent with the view that the quality of lumber in BC did not fall as the Grade 4 share rose."

At its essence the Neuberger report, and the US claim, centre on the timing of changes to BC's timber pricing structure, bringing up questions of what conditions precisely were grandfathered into the 2006 Softwood Lumber Agreement and when. In the Neuberger document, assertions and arguments are heaped on each other for pages on end. Structurally, the report moves on to other subjects then returns to a topic previously discussed. Unravelling the repetition and weeding out extraneous claims (including accusations of 'cooking' or kiln-drying logs to force more cracks than would naturally appear in order to qualify as Grade 4) reveals a fairly tight, but not insurmountable, case.

An equal amount of diligence must be pursued by the Canadian defense. For example, applying alternate logarithms, and a more accurate description of timber harvest practices than simply looking at government figures on harvest levels and stumpage rates.

There is more going on in the woods than can be revealed on paper, or in a spreadsheet.