

MADISON'S LUMBER REPORTER

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News & Updates

BC's "Not Sufficiently Restocked" Timber

Further to discussions about the lack of updates to the British Columbia forest inventory data in various media that have been going on since late last year, BC's Chief Forester Jim Snetsinger submitted an article, titled "Not Satisfactorily Restocked (NSR) Area in BC", for the September/October issue of *BC Forest Professional Magazine*.

Reporter subscribers have had an early taste of the contents of this article. Please refer to the July 29 issue of your *Madison's Lumber Reporter* for details.

Snetsinger provides the same figures and explanations on the issue of reforestation of BC's NSR lands following disturbances by the mountain pine beetle and forest fires that he had provided to *Madison's* back in July. [READ MORE](#)

US Existing Home Sales

Existing home sales unexpectedly rose in October as low interest rates for mortgages and rising rents led more homebuyers into the market, the National Association of Realtors said on Monday.

Sales climbed 1.4 per cent to an annual rate of 4.97 million units from September's revised rate of 4.90 million. Despite the modest increase in sales, the median sales price for existing homes was 4.7 per cent lower, at US\$162,500, in October than it was a year earlier.

Existing homes are selling at roughly the rate they did in the late 1990s. [READ MORE](#)

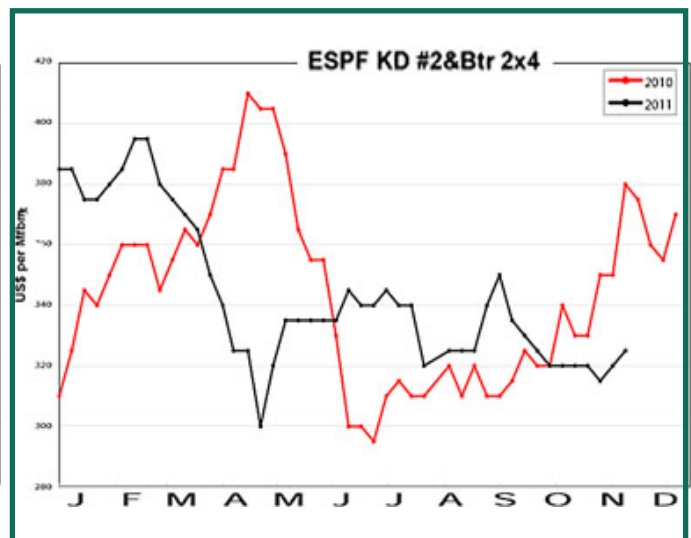
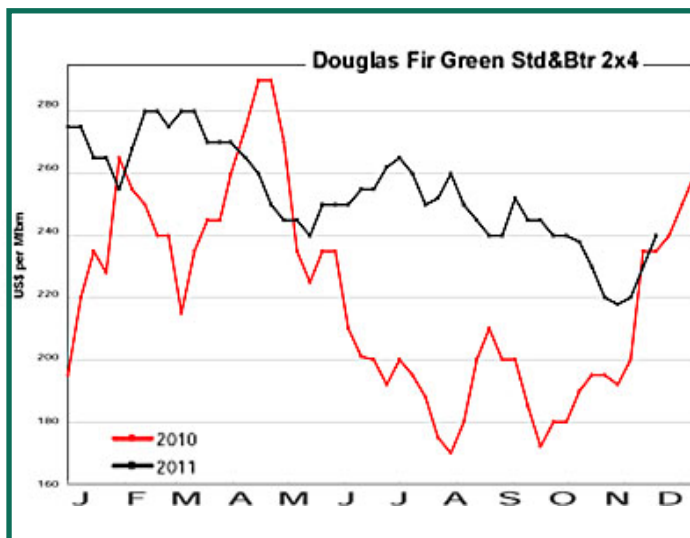
2006 Softwood Lumber Agreement Arbitration

Canada's defense against the latest US claim under the 2006 Softwood Lumber Agreement was released to the media this week, although it has not yet been posted on the federal government's website for public access. After rocking the relevant parties for a few days, *Madison's* was individually emailed the 207 page filing by the communications section of the Department of Foreign Affairs and International Trade.

The bulk of the Canadian defense rests in the legal arena rather than on technical issues specific to the forest industry. While not an international trade law expert, *Madison's* has some grave concerns about the logic behind this Canadian defense and what level of success it will eventually bring in this very important legal arbitration. The possibility of Canadian lumber producers, but only those from British Columbia not any of the other provinces, paying significant additional export taxes on lumber shipments into the US is frightening.

Madison's will provide as clear a summary of the intricate arguments as is possible so readers can decide for themselves about the relative merits of the case.

At its essence, Canada's defense asserts that what the US has alleged, in terms of the harvest of mountain pine beetle infested timber in British Columbia and subsequent alleged subsidies in the form of discounted stumpage fees to salvage the dying and dead timber, is inaccurate and not applicable under the terms of the 2006 SLA. However, given that this arbitration is "not bifurcated" as the Canadian defense states, meaning there are not separate proceedings to determine the validity of the claim and the amount of the penalty, Canada goes on to refute the US claims in detail nonetheless. [READ MORE](#)



Canada Quarterly financial statistics for enterprises

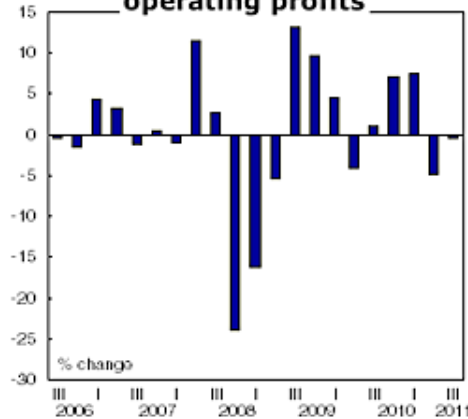
Operating profits for Canadian corporations edged down 0.5 per cent from the previous quarter to \$64 billion in 3Q, Statistics Canada reported Thursday. Declines in the financial sector were largely offset by gains in the non-financial sector. Higher profits were reported by 14 of 22 industries in 3Q.

In the non-financial sector, operating profits increased 3.1 per cent to \$49.4 billion. The main contributors to this growth were retail and wholesale trade as well as mining. Manufacturing profits remained virtually unchanged while oil and gas profits declined.

On a year-over-year basis, operating profits for Canadian corporations were 9.1 per cent higher in 3Q than in the same quarter of 2010. Profits increased 10.2 per cent in the non-financial sector and rose 5.3 per cent in the financial sector.

Operating profits for manufacturing remained flat at \$11.4 billion in 3Q, with half of manufacturing industries reporting higher profits. Tempering the growth in manufacturing was the wood and paper industry, which reported a 43.1 per cent decline to \$268 million.

Quarterly change in operating profits

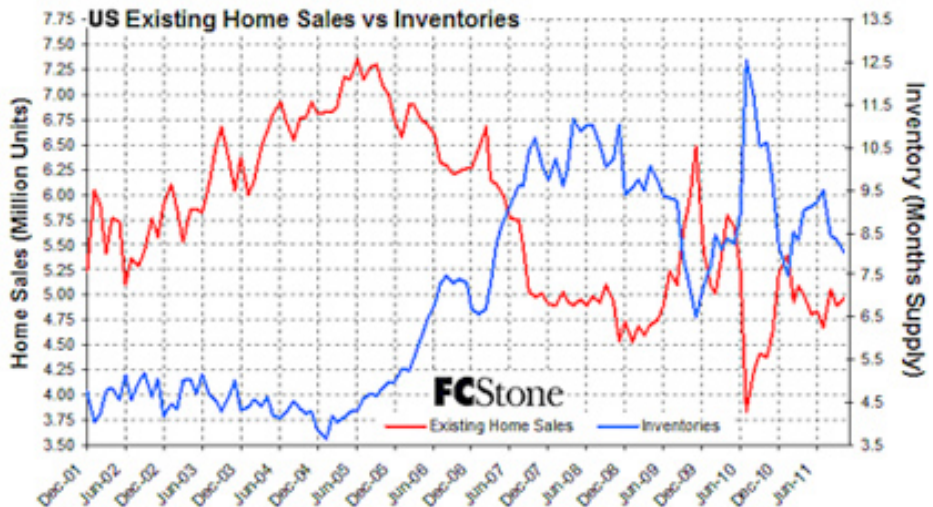


Quarterly operating profits



SOURCE: Statistics Canada

US Existing Home Sales vs Inventories



Data Digest is a weekly construction industry report published by the Associated General Contractors (AGC) of America

US Producer Price Index for Construction Materials

The amount US contractors pay for a range of key construction materials dropped slightly, by 0.6 per cent, in October but climbed 6.9 per cent from the year-earlier level, according to an analysis of producer price index figures released November 15 by the Associated General Contractors of America. Meanwhile, the price contractors charge for new nonresidential building construction edged up only 3.3 to 4.3 per cent over 12 months, depending on building type.

Ken Simonson, the association's chief economist, noted that prices for a number of key construction materials declined during the past month. Prices for diesel fuel dropped 2.2 per cent in October, but are up 27.3 per cent since October 2010 while prices for copper and brass mills shapes fell 8.3 per cent during the past month and -0.2 per cent over 12 months. Meanwhile, prices for gypsum and steel mill products increased in October by 3.0 and 0.4 per cent respectively. Gypsum prices are down 1.0 per cent compared to last year, however, while steel mill product prices are up 13.6 per cent over the past year.

US Construction Employment

Construction employment rose in half the states and decreased in half in October and during the past year, closely matching the stable national employment picture, according to an analysis by the Associated General Contractors of America of Labor Department data released Tuesday. The even split between gains and losses reflects the accelerating improvement in apartment and private nonresidential construction, offset by a declining public market and stalled single-family sector.

Seasonally adjusted construction employment climbed from September to October in 25 states plus DC, led in percentage gains by Delaware, up 5.5 per cent or 1,000 jobs, Vermont, up 3.8 per cent or 500 jobs, and Utah, up also 3.8 per cent or 2,500 jobs. New York state added the largest number of construction jobs for the month, of 3,400 jobs or 1.1 per cent, followed by Virginia, 2,800 jobs or 1.6 per cent) and Utah.

Of the 23 states that lost construction jobs from September to October, Nevada had the largest one-month percentage drop, of 4.6 per cent or a loss of 2,600 jobs. Texas lost the largest number of construction jobs for the month, 12,800 jobs or a loss of 2.1 per cent.

Key Prices

	This Week	Last Week	Change	Month Ago	Change	Year Ago	Change
WSPF KD R/L 2x4	238	240	-2	226	+12	276	-38
WSPF KD R/L 2x6	250	250	0	252	-2	274	-24
WSPF KD R/L 2x8	258	268	-10	260	-2	280	-22
WSPF KD R/L 2x10	250	250	0	255	-5	320	-70
WSPF KD PET 2x4 Stud	235	235	0	220	-5	250	-15
Douglas Fir Green R/L 2x4	230	230	+10	220	+20	235	+5
Douglas Fir Green R/L 2x10	320	315	+5	290	+30	320	0
ESPF KD 2x4 8ft Stud	305	300	+5	305	0	308	-3
OSB Ontario 7/16" (CDN\$)	195	195	0	195	0	200	-5

Weekly News

BC Forest Inventory

CONTINUED Compelling questions remain, however. As the time lag between the most recent full inventory of BC's forests, with 75 per cent of it completed over 15 years ago, and the full scope of devastation in the wake of the pine beetle grows, continued assertions that "It is too early to definitively determine how much of the mountain pine beetle impacted area will ultimately require reforestation", as Snetsinger maintains in both *Madison's Reporter* and *BC Forest Professional Magazine*, ring increasingly hollow.

With all the new technology that the BC Ministry of Forests, Lands, and Natural Resource Operations claims bring efficiencies to the surveying of forests, any excuse for not having done re-surveys by now seems implausible.

Admitting that there is at minimum 2 - 2.9 million hectares of the productive forest landbase in BC "still being harvested and salvaged" then pointing to the same measly 715,000 - 775,000 hectares "currently identified as NSR" that has already been mentioned is frankly inadequate.

The forest industry, and the public at large, of British Columbia deserve to know the hard facts of what is happening to the timber supply on the land base following natural disasters.

Fending off further questions by saying that timber is still in various stages of mortality and will be salvage logged for years to come is an unsatisfactory excuse for not getting ministry staff and contractors out into the forest to do current surveys.

This September, the BC Forest Practices Board became so alarmed by the lack of forest inventory and restocking activity, it started work on a Special Report which will be released in early 2012.

Home Sales, US

CONTINUED Also tempering the outlook for the housing market, the share of contract failures, which happen when banks reject mortgage applications or when appraisals come in below a sale's negotiated price, rose to 33 per cent in October from 18 per cent in September.

One in three real-estate agents who responded to an NAR survey reported that a sale had fallen out of contract in October. Some contracts are falling through because appraisals come in too low and because wouldbe buyers aren't qualifying for mortgages.

There were significant regional differences in the data. In October, sales of existing homes rose 2.8 per cent in the Midwest, 2.1 per cent in the south and 4.4 per cent in the West. But sales declined 5.1 per cent in the Northeast. Lawrence Yun, chief economist of the NAR, said an early snowstorm that took the region by surprise could be blamed for delaying some sales.

Nationally, sales were up by 12.3 per cent from one year earlier, when sales had been depressed by the aftereffects of home-buyer tax credits. Sales dropped sharply in the summer after those tax credits expired. But while the country as a whole was up strongly from one year ago, sales were down by 4.1 per cent in Washington, DC, and by 0.8 per cent in the New York metro area.

While sales are improving, they remain weaker than some economists and housing analysts had anticipated, considering that 30-year mortgage rates in September and October fell below 4 per cent, the lowest level in at least 60 years.

The number of homes listed for sale fell in October to 3.33 million, the lowest level of the year and down by 13.8 per cent from one year ago.

While low inventories are often a sign of health because reduced competition can boost prices, many analysts believe the phenomenon reflects the inability or unwillingness of many homeowners to sell their properties.

Real-estate agents say more sellers are pulling their homes off the market rather than sell at today's reduced prices. About one in four homeowners with a mortgage owes more than their home is worth.

A separate report from mortgage-data firm CoreLogic to be released Tuesday projected that it could take until 2020 for markets to fully digest an overhang of foreclosed properties that represent a "shadow" inventory of potential bank-owned homes.

CoreLogic estimates that there are 1.6 million single-family homes in some stage of default or foreclosure that will ultimately be taken back and resold by banks over the next 18 months. Assuming that homes are sold at roughly the same pace that has existed over the past two years, it would take until 2020 for the shadow inventory to decline to the level that prevailed prior to 2005, said Mark Fleming, CoreLogic's chief economist.

Conifex Reports

Conifex Timber Thursday reported a net loss of \$2.2 million in its third quarter on sales of \$38.2 million.

Current quarter net loss improved by \$1.4 million over the previous quarter, and improved by \$0.7 million over the third quarter of 2010. Overall operating rates based on current total estimated production capacity were approximately 55 per cent during the second and third quarters of 2011 compared to 21 per cent during the third quarter last year.

2006 SLA

Current Arbitration

Please refer to the August 26, 2011 issue of your *Madison's Lumber Reporter* for an analysis of the US claim, and the September 16 issue for a breakdown of the US expert witness report.

The Canadian defense starts by saying that the expert report is flawed in both its calculations and its conclusions, and that the four actions the US claims the BC government took to change "the grandfathered provincial timber grading and scaling system" are not in breach of softwood lumber agreement.

by Kéta Kosman

It is difficult to match the various arguments put forward by each side because each approaches the issues differently. Canada's answer to the individual complaints comes from a different angle than the US claim does.

Right away, paragraph two is confusing because the Canadian defense says, "The central factual assertion on which the United States seeks to erect its claim is that 'the mountain pine beetle does not impair the quality of timber'. That statement is demonstrably untrue". The paragraph cited actually says, "[The BC reforms to its timber pricing system] recognized that the mountain pine beetle does not impair the quality of timber, which can still be used to produce lumber, and therefore recognized that BC should not sell all MPB timber for the minimum stumpage fee." This is all by way of tracking the timeline of changes to the BC timber pricing system, and does not pretend to be "the central factual assertion" of the US claim.

Madison's is alarmed because fashioning a defense against something that is not the complaint seems unlikely to meet with success.

The defense goes on to say that the US solicited expert testimony from a solitary economist, not from "any witness with actual experience managing a forest, harvesting timber, or manufacturing lumber. Nor [...] who has studied the behaviour of the mountain pine beetle."

Canada then uses a tricky logical construct to deflect all examination of the volume of Grade 4, or salvage, timber harvest compared to the volume of #2&Btr, or merchantable, lumber produced during the disputed years of 2006 through 2009. The Canadian defense maintains that the US claim states "(1) that the SLA implicitly imposed a ceiling [...] on the percentage [...] that could properly be graded as Grade 4; and (2) [...] unaccompanied by a significant decline in the quantity and value of lumber produced must demonstrate misgrading. [...]" Then explains, "Canada will show that [...] no one pretended to be able, in 2006, to anticipate all the effects that the MPB might have [...] and that the SLA did not guarantee a certain percentage of Grade 4 logs."

This is troubling because that does not appear to be what the US claim says. Again, not

a legal expert, but it seems worthwhile to present a defense against what the actual claim is.

In *Madison's* understanding of the US claim, the focus is on changes to the provincial timber pricing system in April 2006 to better account for log degradation following the mountain pine beetle infestation. At issue, the US maintains, is that BC "quickly abandoned the new [April 2006] reforms beginning in early 2007". In its claim, the US doesn't delve into the details of this alleged abandonment in the same way it does for both the pre- and post-April 2006 timber pricing methods.

The crux of the US argument seems to revolve around the difference in the volume of Grade 4 logs harvested during the course of those timber pricing changes, of approximately 20 per cent of the total BC timber harvest, rising to 44 per cent by 2008, then to 55 per cent between 2008 and 2010. The US asserts that the volume of merchantable lumber did not decline to a similar ratio during that time, and suggests this is because #1 and #2 sawlogs were misgraded as salvage.

The US claim does not say there is a ceiling on the percentage of Grade 4, as the Canadian defense maintains. In direct response to this point, however, Canada does offer more insight, saying that this US conclusion, "mistakes the relationship between timber quality and lumber production."

Canada also points out, rightly so, that "the total volume of BC's pine harvest declined steadily from 2006 through 2009, so that a large shift in the percentage of pine graded as Grade 4 corresponds to smaller increases in the actual volume." Meaning, as the total amount of timber harvest fell due to lack of demand for lumber, the ratio of Grade 4 logs increased by more than the total volume of Grade 4 logs. In itself, this is an extremely critical point and may go far in supporting Canada's case.

Canada continues by saying that BC lumber producers were able to moderate the effects of the MPB infestation "by vigorous efforts and significant capital expenditures", and by developing "new markets, notably in China, for increasing quantities of lumber of lower quality."

The Canadian defense also says that the US does not sufficiently demonstrate a circumvention claim under the SLA, because the US does not show that the BC government took an action, and does not show that the action provided a grant or benefit to Canadian softwood lumber producers or exporters. Canada then explains at length that the US does not prove that any changes to log scaling, kiln drying of logs, and bucking practices, were directly a result of government action.

Given that it is the BC government which sells the timber and indeed which

sets the log grading and scaling requirements, it's difficult to agree with the above assertion.

The Canadian defense then turns its focus on the proposed remedy. As stated at the outset, this arbitration will deal with the US claim and the amount of damages all at once. Canada maintains that upon arriving at the requested penalty, the dreaded US\$499.2 million, the US expert witness' "benefit calculations contain egregious calculation errors". In addition, Canada explains that BC timber prices during the worst of the lumber market downturn, 2007 through 2009, fell by less than that in the US, and at the same time BC's share of the US lumber market fell from 19 per cent in 2006 to 16 per cent in 2009 and in 2010. Canada then states, "If British Columbia had actually been flooding the market with cheap timber [...], its share of the US lumber market to have risen."

Again, the reader is confused. There is talk of logs and lumber in the same argument. Timber sales and lumber exports are two entirely different things. The data does not track in parallel, each market - that of logs and that of lumber - operates on its own. They are not interchangeable. Also, speaking about BC timber "flooding the market" doesn't really make sense because it is the policy of BC Timber Sales to offer logs to BC buyers first. Only if no BC buyers make a bid are those logs then offered to buyers from other regions, like Japan, China, or the US.

That brings us to page 14 of the Canadian defense. The remaining pages break down the above arguments into ever increasing detail. On page 206 Canada says, "it is unlikely that any adverse effects on US markets could be tied to BC exports." Given the scope and breadth of Canada's defense, *Madison's* is uncertain whether Canada's claim of no wrongdoing therefore of no penalty will be enough to convince the tribunal.

A red flag in the US claim appears again in the Canadian defense. Discussions by both sides about a sharp rise in the availability of Grade 4 logs as the MPB infestation progressed focus on the increase in #3/Utility and #4/Economy lumber produced only as a function of supply. However, the reality that the ratio of low grade lumber increased markedly when compared to that of the standard #2&Btr is precisely due to this new customer base in China. Had this new demand from China not happened, had Canada continued to rely on the US housing market as its major lumber customer by far, production volumes of both #2&Btr and #3/Utility would have dropped.

BC lumber producers did not manufacture more utility grade lumber during the disputed period only because the volume of beetle-kill timber harvest increased, they produced more low grade because they were able to sell more.

The US has until December 23 to file its rebuttal to the Canadian defense, and Canada has until February 1, 2012, to submit a rebuttal of that rebuttal.

Madison's will analyze each respective document as it comes out.