

Western Timberlands

WESTERN TIMBERLAND VALUES AND LOG PRICES

Timber Harvesting was virtually halted on National Forests in the U.S Pacific Northwest in 1992 in an effort to protect breeding habitat for the northern spotted owl. This caused a tremendous increase in timber prices and timberland values. Figure 1 shows the NCREIF Timberland Index (published by the National Council of Real Estate Fiduciaries— NCREIF) for the Pacific Northwest since 1990 (1987=100) and log prices for Douglas fir and whitewood (western hemlock, larch and true firs). The log prices shown here are from Log Lines, Oregon Department of Forestry and Pacific Rim Wood Market report and are a weighted average of a half-dozen domestic and export grades.

Initially, log prices for both Doug-fir and whitewoods rose sharply. But beginning in late 1993, Douglas-fir log prices tended to run \$150-200 per MBF higher than whitewood prices. In fact, the overall trend for whitewood prices has been down since the great peak in mid-1993. Douglas-fir prices showed a great deal of volatility around the \$800/MBF level until the Asian Economic Crisis in the fall of 1997. Since then, they have fallen from an average of around \$800/MBF (and a peak of \$900) to a current average of around \$600.

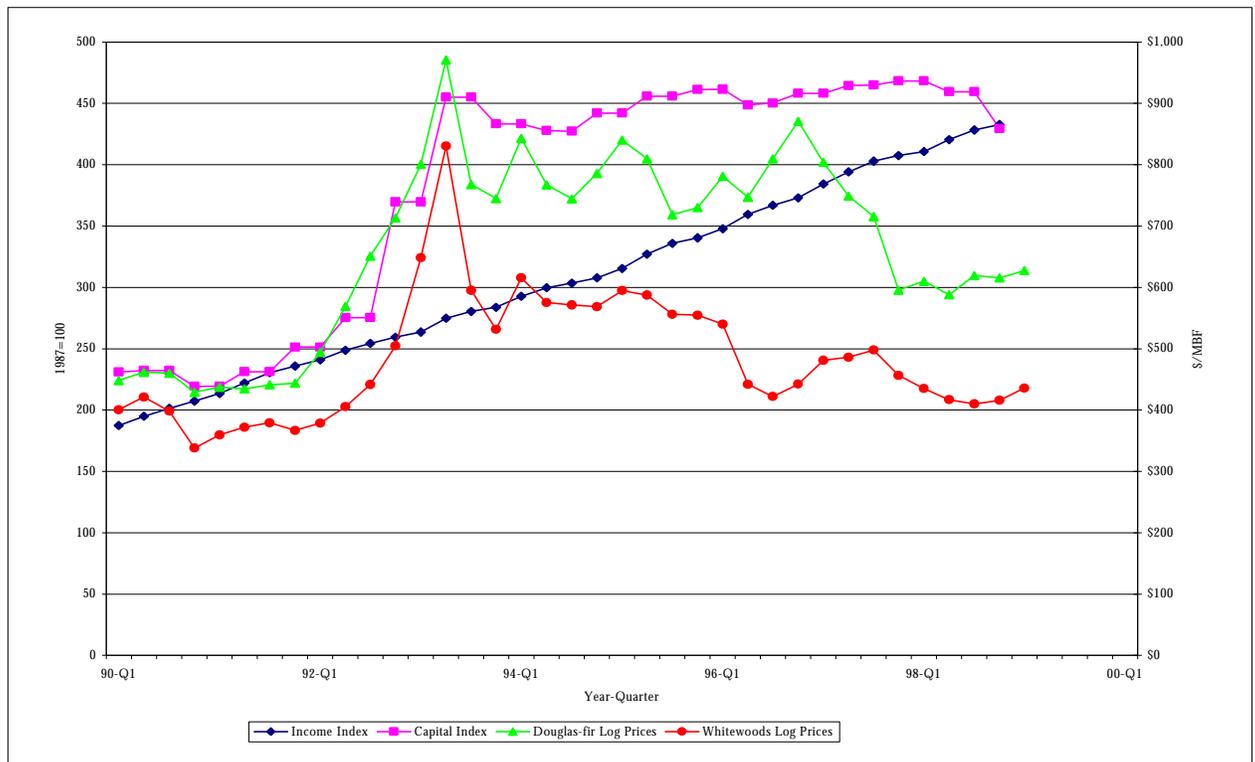


Figure 1. NCREIF Timberland Index (PNW) and PNW Log Prices

An optimist looking at Figure 1 might say that both Douglas-fir and whitewoods prices have bottomed out. Indeed, whitewood prices are about where they were in 1990. However, it is only during the past five years that Douglas-fir prices have been so much higher than whitewood prices. Why should the price differential remain at \$200/MBF? What is to keep Douglas-fir prices from falling further?

EXPECTATIONS FOR WESTERN TIMBERLAND VALUES

Note the relationship between the Capital Index and Douglas-fir prices in Figure 1. The **value** of PNW timberland rose right along with Douglas-fir prices in 1993, and stayed near that peak value until 1998. However, as log prices began falling in 1997, timberland values did not. Why did timberland values rise so closely with log prices, yet not fall as quickly? It may be that in 1997 and early 1998, potential investors were willing to pay “high” prices for timberland as a long-term investment in spite of the falling log prices. If current investors had expectations that log prices would rebound in a short time, then they would not be willing to sell existing holdings “cheap.”

There are signs that investors’ expectations are changing. The chart shows a slight drop in value between the 1996 fourth and 1998 second quarters, and then a much sharper drop in the fourth quarter. Overall, the NCREIF PNW Index was down 38 points or just over 8 percent in 1998. It is important to remember that very few NCREIF properties are appraised in the first and third quarters. Most properties are appraised in the second quarter and all properties are appraised in the fourth.

RECENT WESTERN TIMBERLAND RETURNS

Figure 2 shows quarterly returns for the NCREIF PNW properties since 1990. This chart clearly shows the volatility investors can expect in the West, including negative returns in the second and fourth quarters of 1998. (In this chart, capital returns for the first and third quarters have been removed. Removing these quarters reduces the apparent volatility of the capital returns because every other quarter has a capital return equal to or nearly equal to zero. They are usually equal to zero because there are no appraisals. In some quarters, new properties will affect the index and returns, but the total impact on returns in such quarters is negligible.)

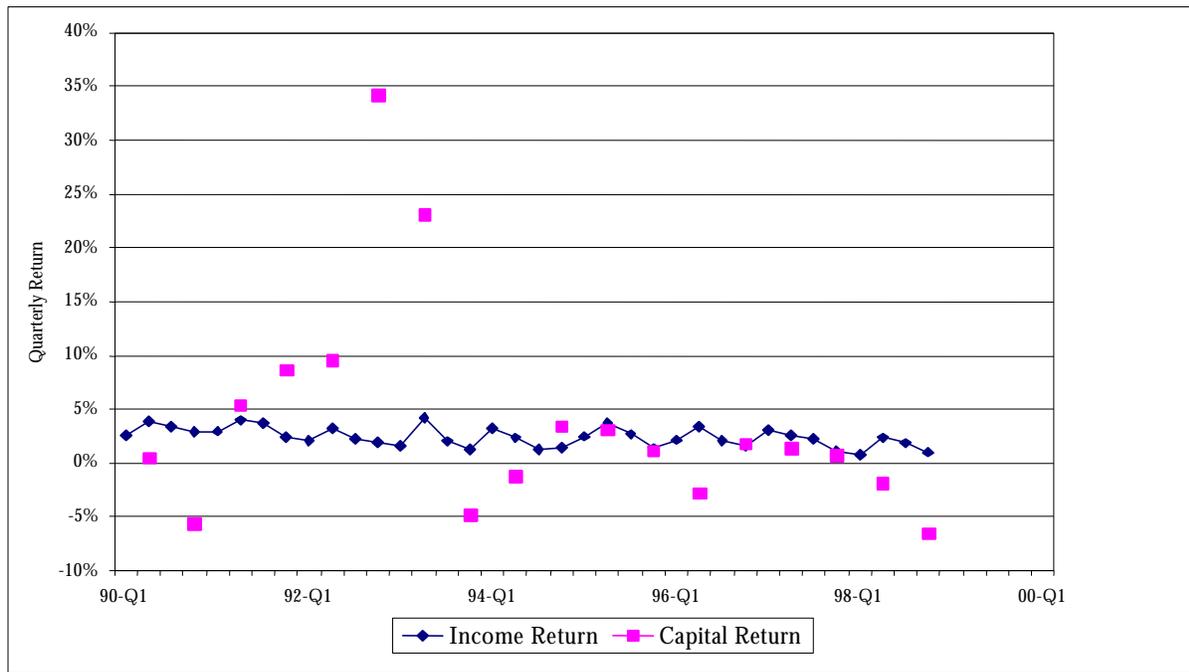


Figure 2. NCREIF Timberland Returns (PNW)

IMPACT OF EXPORT MARKETS ON THE WEST

The drop in log prices since 1997 is due largely to the sudden disappearance of Asian wood buyers in Western markets. Figure 3 shows the sudden drop in Douglas-fir log prices occurred mostly in the export log grades. Japan 12 logs fell from \$1,200/MBF to a low of almost \$600/MBF. Late in 1997 some export grades were selling for less than the two domestic grades shown here.

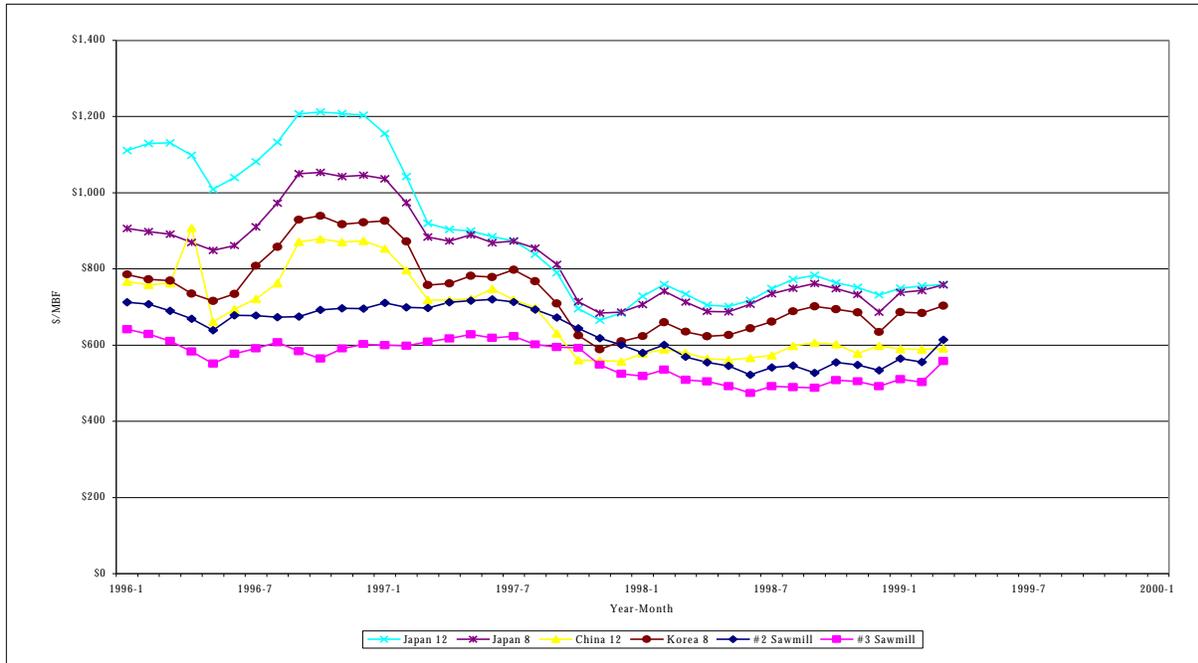


Figure 3. Domestic and Export Grade Prices for Douglas-fir Sawlogs

Domestic prices were forced down by the availability of export wood sitting on Western docks with no overseas markets. However, export grades are not directly substitutable for domestic grades. Export logs tend to be butt logs, and Asian buyers are quite happy to pay extra for the butt swell, which is chipped to supply fiber for Asian paper mills. Most modern domestic U.S. mills are configured for smaller second (and third) logs and are not so willing to pay for butt swell and large logs. This resulted in lower prices for Douglas-fir domestic grades, but only about \$100/MBF lower. Meanwhile, prices for export grades are down \$200-400/MBF.

Whitewoods sawlog prices show a slightly different pattern (Figure 4). Whitewood prices have been dropping steadily since 1994. While appearing to recover slightly during 1996, the Asian crisis has driven them back down since then. In this species group, western hemlock has been under particular strain. In some markets, western hemlock is being replaced by radiata pine. This is particularly true in Korea, where the ratio of log imports was 80 percent hemlock to 20 percent radiata in 1980, but has reversed to 20/80.

WHAT'S NEXT?

When will Western timber prices (and timberland values) recover? Western timber markets require strong demand in Asia. When will Asia recover?

There is escalating domestic violence in Indonesia, which may settle down after an up-coming election. There is speculation that the Chinese will devalue the yuan. But most Asian economies seem to have stabilized (or bottomed out). However, stabilization is not the same as growth. Japan is struggling to jump-start its economy, but has had little success so far. The central bank has driven interest rates to nearly zero with little impact to date. It is unlikely that all of

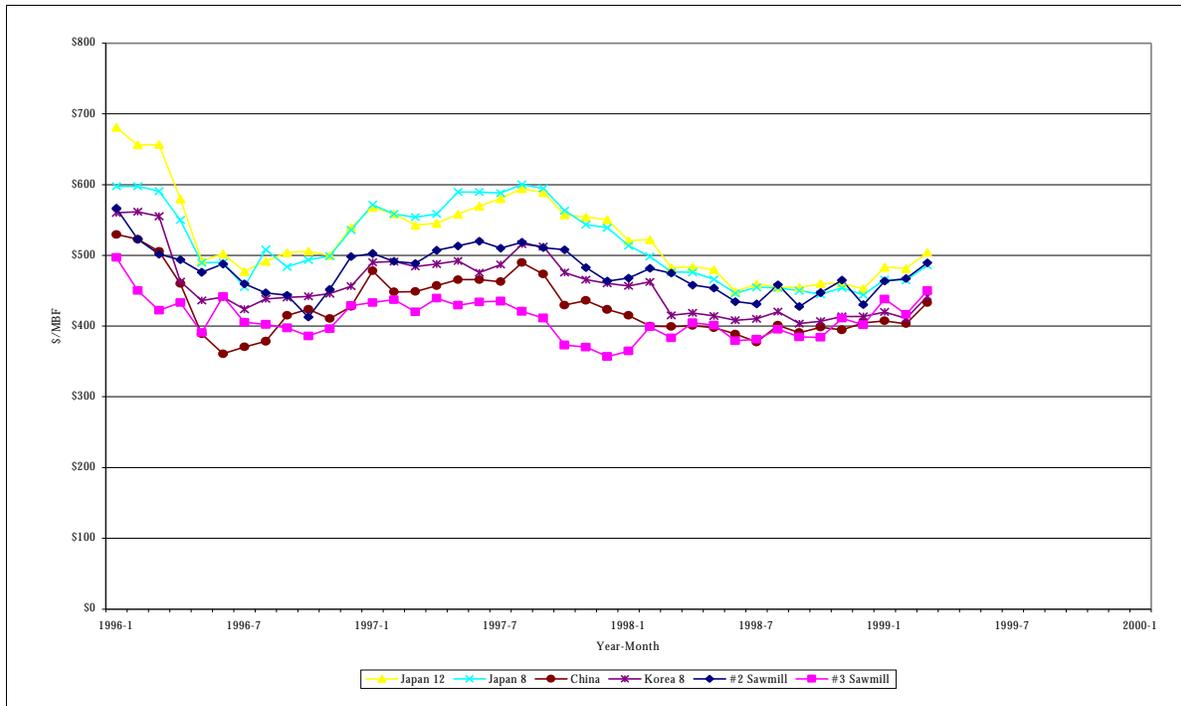


Figure 4. Domestic and Export Grade Prices for Whitewoods Sawlogs

Southeast Asia will recover in 1999. We may have to wait until 2000. A full recovery of western log prices depends on several things, including the economic health of Asia, Russia, and Brazil. Many ailing economies will attempt to become healthy by increasing exports. The only really strong economy right now is the U.S. The Western U.S. faces further reduced demand for wood and an increase in competing wood imports. Here are some things to watch:

1. Asia must get better.

2. Europe must not get worse. The Russian economic crisis appears to have had little world impact. However, Europe is expected to show little or low growth over the next year or two, in part because of investments in Russia. If the Scandinavian lumber and paper producers cannot find markets in Europe and Russia, they will expand shipments to Asia and the United States.

3. Brazil's economic problems must not spread. If Brazil's economy contracts sharply and other South American countries have problems, more wood from the region will find its way into world markets.

4. Western wood must compete successfully against radiata pine (and Scandinavian species). In addition to hemlock losing ground to radiata in Korea, radiata pine is also being shipped into the United States as a substitute for ponderosa pine in millwork applications.

Timberland Report VOL. 1, NO. 1 Copyright © 1999 James W. Sewall Company. All rights reserved.

The *Timberland Report* looks at the timberland investment industry with an emphasis on the United States. The opinions expressed are those of the editor, who is solely responsible for its content, and may not reflect the opinions of James W. Sewall Company.

Editor: Jack Lutz, Ph.D., LPF, Resource Economist

(207) 827-4456 (207) 827-3641 (fax) www.jws.com jack.lutz@jws.com