

Southern Timberlands

SOUTHERN TIMBERLAND VALUES AND STUMPAGE PRICES

Figure 1 presents quarterly timberland indexes and stumpage prices in the South for the past five years. The timberland index data are from the NCREIF Timberland index and the stumpage prices are unweighted southwide averages of Timber Mart-South prices. (Note that the pulpwood prices shown in the chart actually represent the price of 10 cords. This allows the pulpwood price to appear on the same scale as the sawtimber prices.) As with the Pacific Northwest and the Northeast, the Income Index shows income returns plodding along at a nice steady pace. Quarterly income returns since inception have averaged just under 1% per quarter, with a standard deviation about 0.4%. The Capital Index shows more volatility, but some of this is due to most properties being appraised in the second and fourth quarters. It will be interesting to see if the low prices for pine pulpwood will have a major impact on timberland returns in the near future.

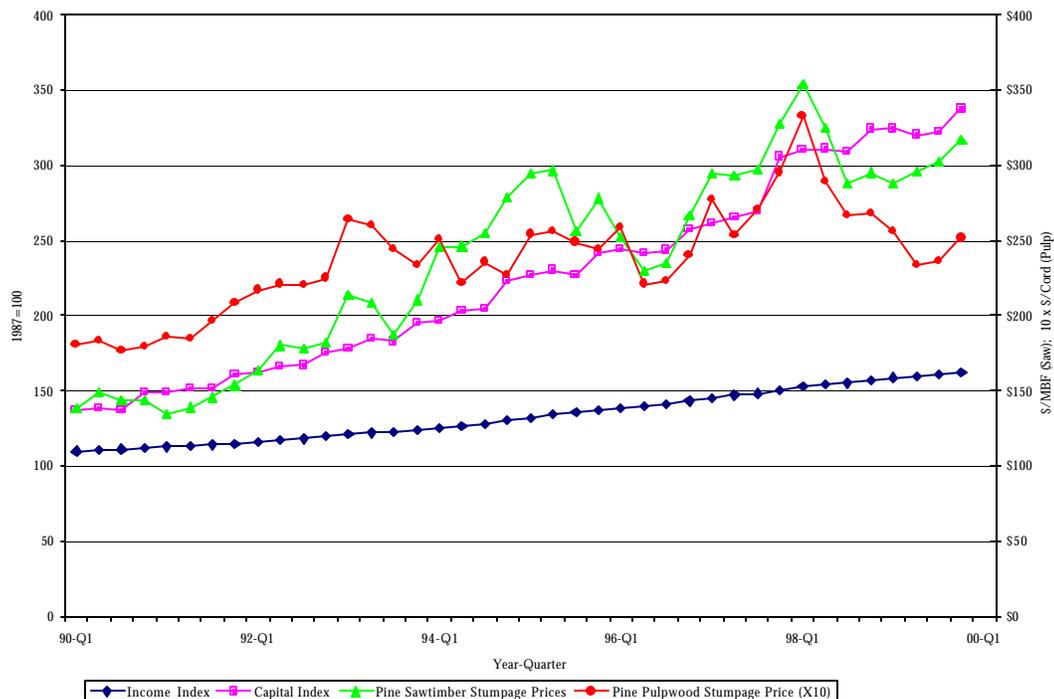


Figure 1. NCREIF Timberland Index (South) and Southern Stumpage Prices

What is happening to those pulpwood prices? For now, I will blame a drop in demand. Over the past year or two, a number of pulp mills in the South have closed. They have closed partly as a result of the economic crisis that began in Asia in late 1997. A drop in demand for pulp and paper products in Southeast Asia caused some global readjustments that helped make some southern pulp producers the higher-cost producers, and some mills were closed as a result. The table below provides a list of mills and production capacity closed as reported by Resource Information Systems, Inc. While there is some skepticism that these mills will remain closed (especially as Asia, even Japan, seems to be perking up), these closures account for some of the softening in pulpwood prices.

Company	Location	000 metric tonnes
Smurfit-Stone	Port Wentworth, GA	580
Kimberly-Clark	Mobile, AL	520
Donohue	Sheldon, TX	500
Florida Coast Paper	Port St. Joe, FL	500
Pasadena Paper	Pasadena, TX	350
Smurfit-Stone	Jacksonville, FL	320
Alliance	Coosa Pines, AL	200
Total		2,970

Source: Resource Information Systems, Inc.

SOUTHERN TIMBERLAND RETURNS

Figure 2 shows annual returns for the NCREIF Southern properties since 1987. The dotted line is a trend line (plotted automatically by Microsoft Excel). This trend line slopes *very slightly* downward—about 2 basis points per year. If the (apparently exceptional) returns for 1994 and 1997 are removed, this line would have a steeper downward slope.

Why are southern timberland returns “falling” at the great pace of 2 basis point per year? Well, they may be falling to levels where they are supposed to be. The NCREIF Timberland Index reports that southern timberlands have had a return since inception of 13.8% (nominal). In a recent, very informal, unscientific poll of timberland investment managers and forest economists, I found that many of them tend to think timberland should produce returns in the 7-9% (real) range, with southern timberlands being near the middle of that range. You can provide your own inflation numbers, but if you assume inflation has been running at 3-4% in recent years, southern timberlands have been providing returns of around 10% real. Does the fact that 1998 and 1999 had the lowest annual southern timberland returns since inception mean that returns are approaching “normal” levels?

On the other hand, it is also possible that the return expectations of timberland investment managers and forest economists are too low for southern timberlands. Those expectations had been based on theoretical models using timber prices, agricultural land prices and other proxies for timberland values until actual returns became available from the Timberland Performance Index (TPI) and the NCREIF Timberland Index. With 18 years of data available from the TPI and 12 years available from NCREIF, perhaps it is time to revise expectations for southern timberland returns.

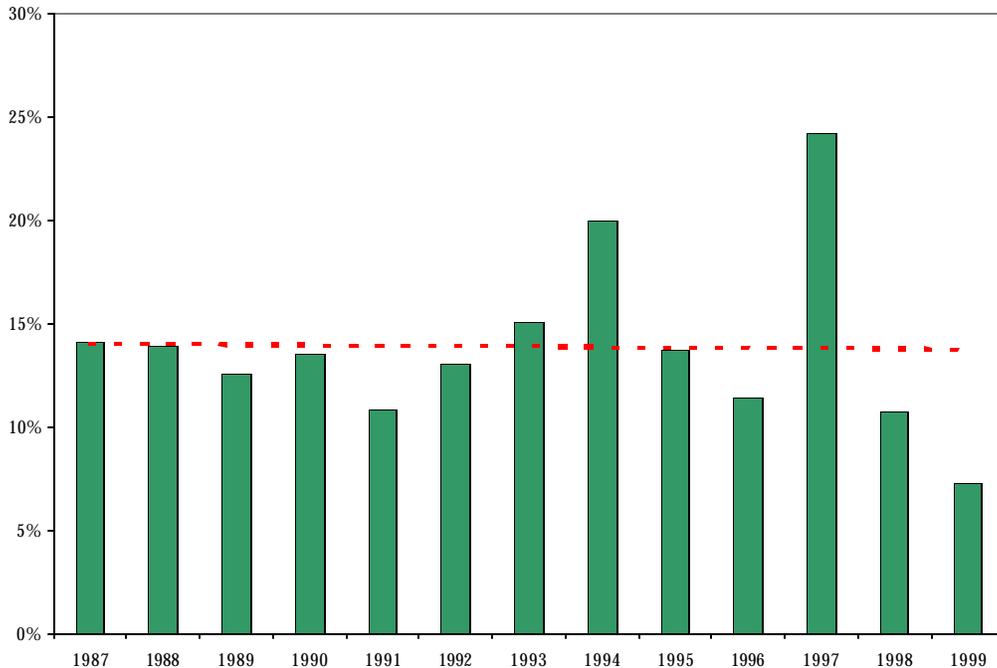


Figure 2. Annual Total Southern Timberland Returns (NCREIF Timberland Index)

INCREASING LIQUIDITY?

If southern timberland returns are actually about 10% (real) per year, is there a problem with them apparently decreasing in recent years? Or if the returns “should be” around 8% (real), why are they dropping there from 10%? Part of 1999’s lower returns are due to changes in markets (e.g., the drop in pine pulpwood prices caused by closing pulp mills.).

However, I think another reason for lower returns might be an increase in the efficiency of timberland markets in the South. This increase in efficiency is a result of more timberland buyers and sellers and an increase in available information. About 15 years ago, there were 5 or 6 major timberland investment managers in the South. These included the oldest players such as the Hancock Timber Resource Group, Wachovia Timberland Investment (and/or its predecessors), Travelers, Resource Investments, Inc. (now part of UBS Brinson) and Forest Investment Associates.

Now there are at least a dozen investment managers operating in the South:

1. Hancock Timber Resource Group
2. Wachovia Timberland Investment
3. Forest Investment Associates
4. Timberland Investment Services
5. UBS Brinson (formerly Resource Investments, Inc.)
6. Prudential Timber
7. Forest Systems, LLC
8. Forestland Group
9. Molpus Woodlands Resource Management Group
10. Strategic Timber Trust (recently sold its major southern property).
11. U.S. Forest Capital
12. Resource Management Service (providing acquisition support to non pension-fund clients)

I am sure I have missed one or two and they will let me know who they are. This list does not include Plum Creek and other REITs/MLPs, nor a number of wealthy individuals that have always been operating in the south, (nor several timberland investment managers operating primarily in the West or Northeast).

This growing list of players in the southern timberland market suggests the liquidity premium formerly earned by timberland investors may be shrinking. The risk of being unable to sell timberland within a reasonable time at a reasonable price is lower now than it was 15 years ago. If the liquidity risk is decreasing, the return required by investors should be decreasing as well

TIMBERLAND INVESTMENT NEWS

Forest Systems LLC of North Easton, Massachusetts began contributing data to the NCREIF Timberland Index beginning in the fourth quarter of 1999. The southern returns discussed above include those of Forest Systems.

It appears that a number of other timberland investment managers who are not currently contributing data may begin to do so soon. The Campbell Group of Portland, Oregon and UBS Brinson (the timberland investment group is located in Lebanon, New Hampshire) are now managing timberland investments for CalPERS, and we expect that they are looking hard at becoming contributing members. Unconfirmed rumors suggest two or three others will also contribute.

In Volume 1, Number 3, we discussed the impact of a large property in Pennsylvania on the NCREIF Northeast Timber Index. We have been informed that the property has been withdrawn from the index.

In Volume 1, Number 4, we discussed the Timberland Performance Index (TPI), published by Dr. Jon Caulfield at the University of Georgia. We recently learned that Dr. Caulfield will be joining Timberland Investments Services, headquartered in Woodstock, Georgia. The future home of the TPI is uncertain.

FINAL THOUGHTS

As I sit typing this newsletter (Friday, April 14, 2000) I am listening to the stock indices crashing, or correcting (as they have been all week). This is good for timberland investment. One of the selling points for timberland is that timberland returns are negatively correlated with stock returns. If stock returns are going up, timberland returns should be going down. Both have been doing well for the last few years. A crashing stock market will reinforce the benefits of timberland investments.

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