

Southern Timberlands

SOUTHERN TIMBER PRICES

Southern pine prices have been slipping since they peaked in the first quarter of 1998. Figure 1 shows prices reported by Timber Mart-South through the fourth quarter of 2000. Causes for the price movement range from industry consolidation to weather conditions and insect infestations.

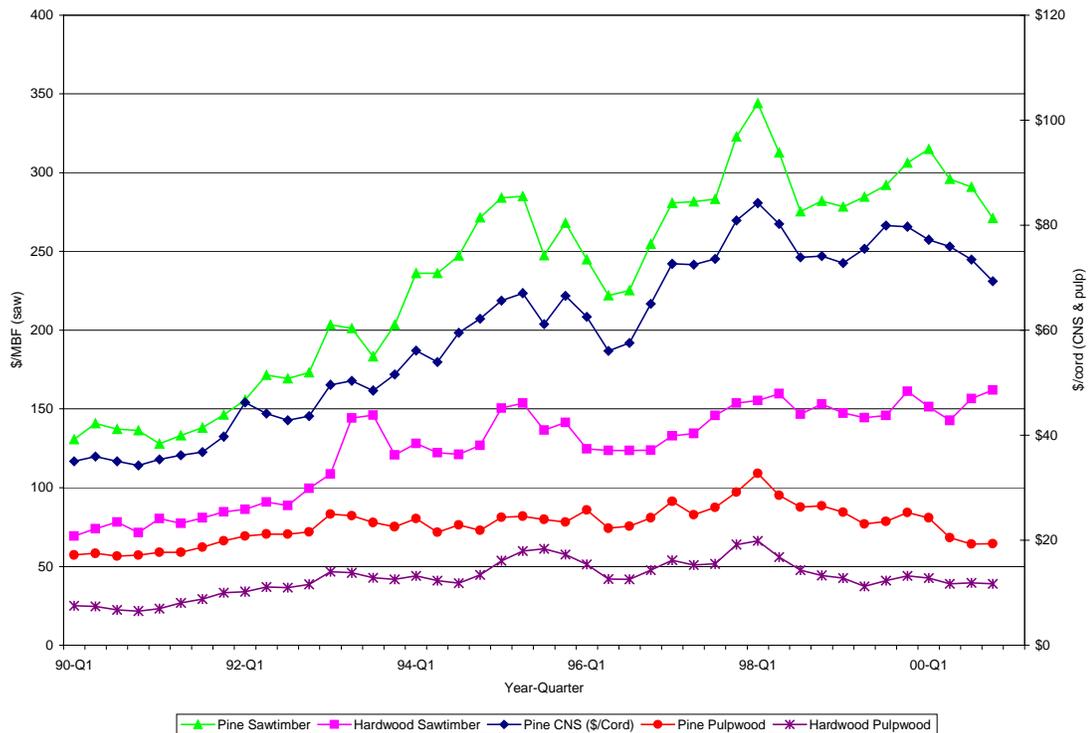


Figure 1. Recent Southern (Southwide) Stumpage Prices, Timber Mart-South

Note that the “slipping” pine sawtimber prices are still 107% higher than they were in 1990 and chip-n-saw prices are 98% higher. (Pulpwood prices have not shown comparable increases!) Hardwood sawtimber prices have done the best of all, increasing by 134% since 1990.

Timber price publications kept reporting in 2000 that Southern wood producers were hoping that pulpwood prices had bottomed out. This proved to be a false hope, as pine pulpwood prices kept dropping through the third quarter, but they did manage to level off in the fourth quarter.¹ The weakness in pulpwood prices is due in part to pulp mill closures across the South over the past 12-18 months. Pulp prices have shown some improvement as a result of these closures and the decrease in pulp supply that they represent. Pulp markets are currently in turmoil, with analysts divided on whether prices can keep rising or even maintain their current levels. It will be interesting to see whether the closed pulp mills will stay closed if prices continue to rise. The industry has historically reopened closed pulp (and paper) mills as prices rise, quickly increasing supply and causing prices to fall again.

The mill closures are one aspect of industry consolidation. The new, larger paper companies are able to close machines and mills that have become a smaller portion of total production. An additional result is the reduction in the number of companies competing for timber. The former Champion International, Union Camp, and Federal Paperboard mills are now part of the International Paper organization. Georgia-Pacific has now acquired Fort James as the company is changing its focus from that of a commodity producer to a consumer products company. Mills that used to compete for pulpwood are now coordinating their efforts within a single procurement department to make sure they are not competing for wood against their own mills.

Large volumes of pulpwood are on the market across the South from mid-rotation thinnings. While timber can usually be held on the stump when prices are low, these precommercial thinnings must be cut within a year or two of the scheduled cut. Delaying mid-rotation thinnings to wait for higher timber prices will reduce overall growth in the stand and impact future returns.

Pine sawtimber prices have fallen partly in response to lower lumber prices. Lumber prices were flat during the third quarter of 1999 and the first quarter of 2000, but lumber production remained high through June 2000. Softwood lumber production curtailments began in June. As many as 200 sawmills across the country shut down for some period of time from June through August, about a third of them in the South. Curtailment announcements were still being made in November 2000. Most lumber and panel prices are below year-ago prices.

Weather conditions have also contributed to the high level of the wood supply across the South, both sawtimber and pulpwood. Most of the region has been experiencing below-normal rainfall for the past three years. This dry spell began with a spectacular fire season in the summer of 1998. The fires put large volumes of fire-killed timber on the market. Seasonal heavy rains usually restrict or halt logging operations, and these heavy rains have not occurred in recent years, allowing many loggers to operate all year without restriction. These increased operating days have boosted the supply of wood on the market.

¹ Based on prices published by Timber Mart-South.

Finally, the southern pine beetle is putting wood on the market. The beetle kills trees and spreads rapidly outward from the point of infestation. Beetle-damaged trees must be cut to prevent the spread of the beetle to the rest of the pine stand and the damaged timber must be utilized quickly if it is to be utilized at all.

SOUTHERN TIMBERLAND RETURNS

So how has this less-than-wonderful news on timber prices affected timberland?

Figure 2 shows the NCREIF Timberland Index income and capital indexes for Southern timberlands through the third quarter of 2000. The income index is flattening a very little bit (the average quarterly return for 1997 through 1998 was 1.75 percent, while the average quarterly return for 1999 through Q3 2000 was 1.28), a reflection of falling timber prices. But the capital index does not seem to be reflecting the drop in timber prices.

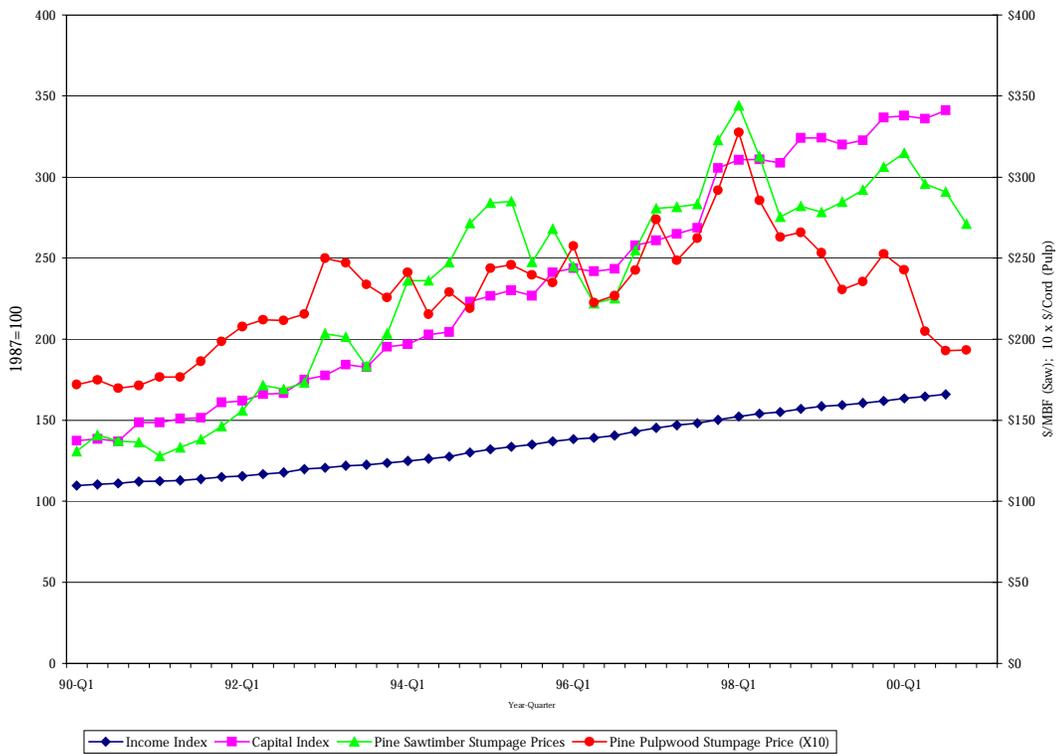


Figure 2. NCREIF Southern Timberland Index and Southern Pine Stumpage Prices

There are a couple of factors that may be contributing to this lack of response.

In the first place, timberland properties are not normally appraised for the NCREIF Timberland Index during the third quarter. A large number of properties are appraised in the second quarter and all are appraised in the fourth quarter. The increase in value in the third quarter, as indicated by the increase in the capital index, would be due to appraisals on a limited number of properties or small additions to existing properties, rather than a measured increase in value of most of the properties in the index. Appraisals in the fourth quarter may show a drop in value.

Second, Figure 2 may demonstrate that timberland value is not entirely dependent upon timber value. Increased demand for timberland as an asset class may drive up the value in spite of falling timber prices. If the market is expecting a turn-around in timber prices in the near-future, timberland buyers would be willing to pay prices that appear to be high in the face of current prices.

It will be interesting to see if year-end appraisals attach significant weight to the falling timber prices. The fourth quarter 2000 NCREIF index should be available early in February.

ICE STORMS

Potential timberland investors often ask about the risk of catastrophic damage to timberland from fire, insects and disease. Most do not think to ask about weather damage. In addition to hurricane damage, timber is also at risk from ice damage.

A significant ice storm hit Arkansas and Texas at the end of the year 2000. National news coverage focussed on Arkansas and its power outages, but the forests of both states took a beating. The Texas Forest Service has estimated damage to that State's timber at a minimum of \$46 million. Damage to timber in Arkansas is likely to be much higher. Most tree species are good at supporting snow, but they are not good at standing up to 4 inches of ice.

This event follows two other major ice storms in recent years: northern Mississippi was hit hard in 1994 and northern New England and New York were hit in early 1998. How serious a problem are ice storms? The chances of being hit are small, but damage can be heavy. These storms can be devastating for the small woodlot owner who holds 40 or 100 acres. But this is also true of hurricanes, fire, insect and disease. Institutional and other large investors with geographically diversified portfolios increase their exposure to catastrophic damage, but reduce the amount of risk to the overall timberland portfolio.

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