

# The Trend in Timberland Prices

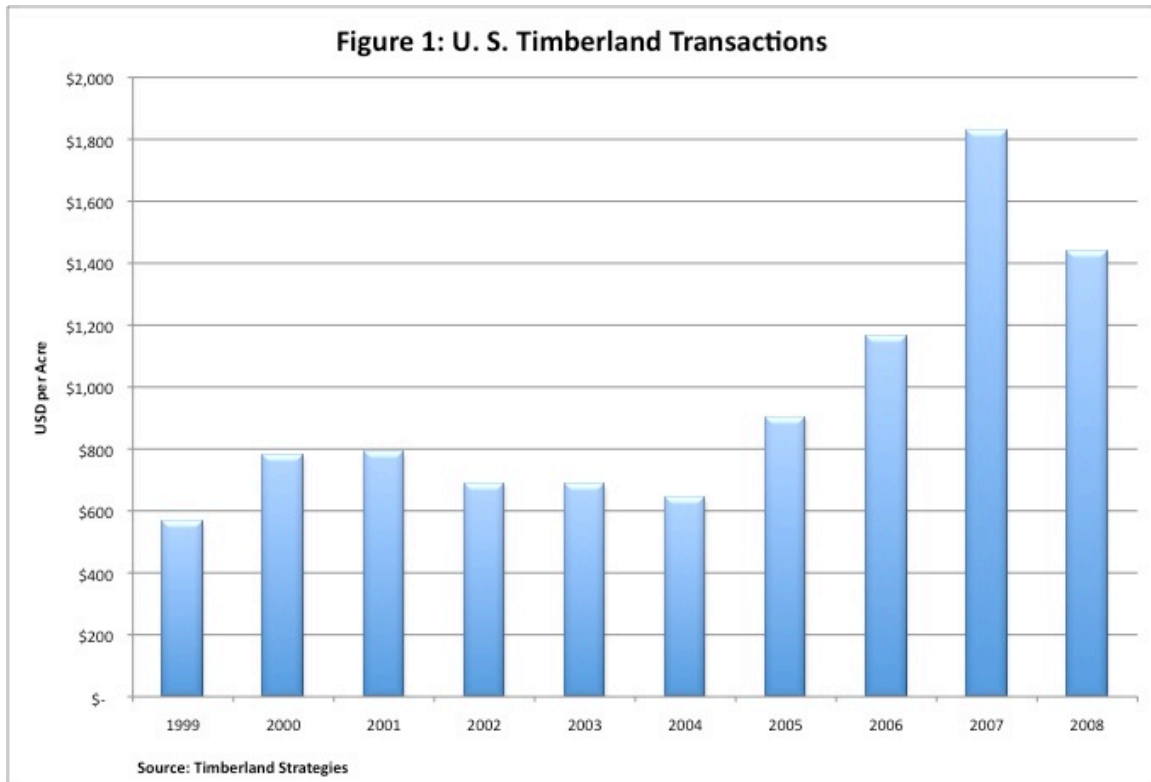
By  
J. Brian Fiacco

This past January, I posted an article to The Timberland Blog that looked at the change in timberland values that occurred during 2008. It seemed that virtually all assets were down in value and I had read, in several sources, that timberland values were too. Stocks of the publicly traded timberland owners had gone down 20% to 60% in the past year or so. The logic is that the decline in housing has caused a drop in lumber price which has created a drop in timber (stumpage) price which has resulted in a corresponding drop in timberland prices. Our family stock portfolio had certainly taken a hit to the downside and logic suggested that our portfolio had taken a hit on the Tree Farm side too. We have Tree Farms in both South Carolina and Northern New York and, like most family forest owners, they represent a significant part of our net worth. But how much did the value actually decline?

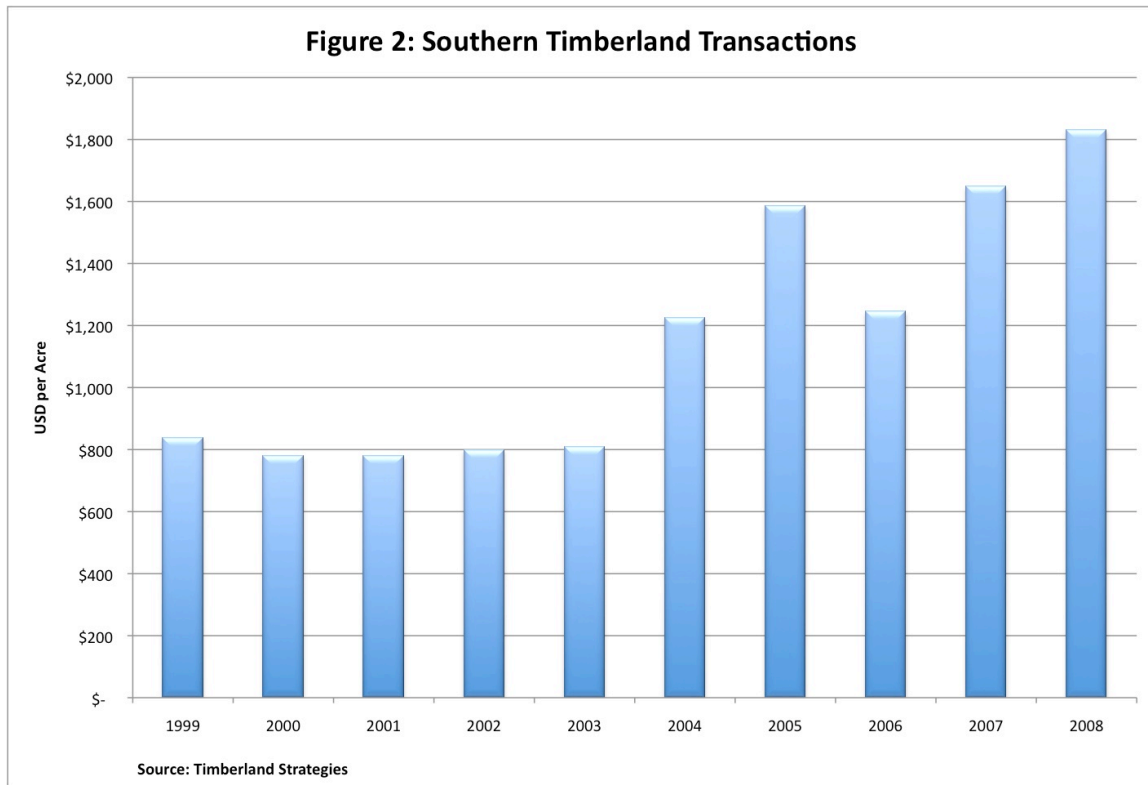
I do some consulting with market analysts and hedge fund managers interested in valuing timberland and the drivers behind it. The most common question that I have heard since the first of the year surrounds the declining value of timberland and just how great that decline is. How can a company like Weyerhaeuser or Plum Creek be properly valued given the logical decline in timberland values?

I have been maintaining a database of the major timberland transactions for over a decade so I wanted to quantify the change between 2007 and 2008. To clarify what we are looking at, the transactions all are large transactions (generally 25,000 acres up to 1,000,000 acres plus). The database is not intended to track sales of timberland the size of the typical Family Forest. Yet these institutional sales do have an impact on the value of our landholdings as well. Most, perhaps not all, of the drivers impacting sale values apply to smaller tracts as well as to the large purchases characteristic of the institutional transactions.

Figure 1 is a chart showing the \$/acre sale price trend for the entire U.S. for the last decade.



This is pretty interesting. Nationwide, it appears that prices have dropped about 20% following a year where they gained almost 60%! BUT... it is important to understand the data and what is happening. This database is composed of transactions that total between one and seven million acres in any given year. Also in the database is a “REGIONS” field. Price distortion occurs between years due to the variation in the percentage of sales occurring between regions (\$/acre varies significantly between regions). The high sale price that occurred in 2007 is actually a reflection of the relatively large number of acres that sold in the high value Northwest. The decline in 2008 is actually a reflection of fewer sales in the Northwest (relative to the rest of the U.S.) rather than an overall decline in prices. So how does the price per acre change if we just look at a single region? Let’s look at the South (Figure 2).

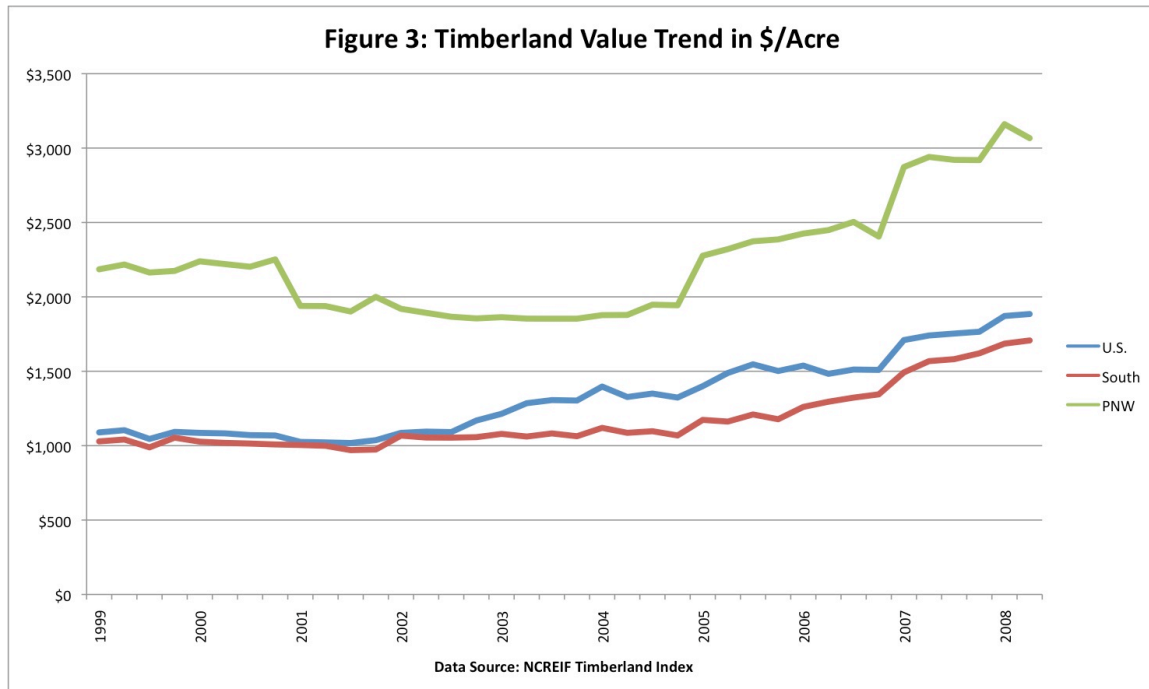


Within any particular region, individual transactions will impact any given years weighted average price. There is a variation between tracts that cannot be identified in the data although large transactions do have a tendency to reduce the variability between tracts. In spite of that, the trend is clear and *it is difficult to find any argument in the data that supports a significant decline in timberland pricing* – at least in the South.

The Northeast and the Northwest regions in my dataset did show a drop last year. The acreage sold in the NE was not particularly large (meaning most of the variability was probably due to the variability between tracts) so I would be reluctant to attribute much significance to the decline. There was one significant datapoint though. The Essex Timber to Plum Creek transaction (at \$267/acre) pulled the average down. It is important to note that there was a conservation easement on this tract. We should expect to see significantly lower transaction values as more sales occur on tracts with existing conservation easements. The sale of a conservation easement provides revenue in the form of an early payment for Higher and Better Use (HBU) land but it can also have a negative impact on future forestry based revenues as well. Not only has HBU value been stripped out but so has some of the flexibility and value of future forest management. Conservation easements should be written with caution. In the Northwest, few sales and annual imbalances between “Westside” (high value) and “Inland” (significantly lower value) can cause huge swings in annual averages for the region.

Let’s take a look at another dataset that looks at trends. The National Council of Real Estate Investment Fiduciaries (NCREIF) maintains sale and appraisal data on the timberland holdings of its members. Figure 3 has been constructed from calculations

made from that data and used with the permission of NCREIF. Again, the underlying data is for large tracts of timberland owned by institutional investors. Although the appraisals are based upon comparable sale data, the advantage of this dataset is that many, probably most, of the appraised tracts are the same from one year to the next, which removes much of the “between tract” variability discussed above as well as much of the “within region” variability. Again, the data does not support the contention that timberland values decreased significantly in 2008. Another supporting checkpoint is that the USDA reported increases in the “Cropland Price” per acre in every region with an average increase of nine percent for the 48 contiguous states last year.



When we look at the first half of this year, what do we see? The last “tick mark” on the graph in Figure 3 is for Q1 2009 which does suggest weakening may be occurring. Here are a few reported sales in the South for the first half of the year.

- Potlatch to RMK: 24,800 acres at \$1,745/acre
- Forestar to HTRG: 75,000 acres at \$1,600
- MeadWestvaco to FIA: 25,000 acres at \$1,960
- Rayonier to multiple: 19,000 acres at \$1,200

There are two more announced transactions (not closed) that exceed \$1,900 per acre but both clearly have HBU values and those values appear to be significantly discounted. The MeadWestvaco transaction also has potential HBU value that is down the road a few years but some of that value is probably in the price.

On the surface, it appears that timberland prices are continuing to hold fairly well but HBU value is being very heavily discounted.

There are also some things that the transactions above don’t show. First, the number of transactions is less than normal. Second, several large tracts were put on the market and

then pulled because the seller did not get the desired price. I read this as “timberland owners are not willing to sell at reduced prices and buyers are generally not willing to buy at the current prices.” It seems that everybody is waiting for a significant move.

A look at the above sellers does suggest something though. They are all public companies and they are all under very real pressure to protect their stock price – generally by selling land to maintain dividends. The raiders and short sellers continue to lurk in the wings and to put downward pressure on the share price. A look at the above buyers suggests to me who the winners will be. They have the courage to capitalize on this weakened sector of the market.

### ***What has caused prices to stay up while timber prices and most investments have declined in value?***

So... what does all of this mean? I can see little decline in timberland values. If sale prices are not declining, what is wrong with the logic expressed in the first paragraph – declining housing starts means declining timberland values?

Here is my take. First, buyers are “looking through” current timber prices. Sophisticated timberland investors use appraisal techniques that look at cash flow from investments over the planned life of the investment. Temporarily low stumpage prices (or temporarily high prices), are generally not used in favor of a “return to trend” timber value. Those timber values are based on their view of the future, not just today’s market. And the future view is for higher stumpage prices driven by a rapidly evolving biomass energy market.

Second, more money is chasing fewer acres. A significant amount of timberland is being transferred to non-timber producing uses, such as preservation, development, and highways, resulting in a declining base of productive timberland. Example: almost all of the 161,000 acres of Finch and Pruyn timberland in the Adirondacks will ultimately be withdrawn from production and become a part of the Forest Preserve. Initially, some went to the Preserve, some to conservation easements and some to a pension fund. Due to the existing easements, when the pension fund sells, the land will almost surely go into the Forest Preserve. An example from the other side (money side) of the equation: recognition of timberland as a separate investment asset class has caused (and will continue to cause) large quantities of money to flow into timberland investments. The United Nations recently announced that its pension fund would diversify its portfolio and seek to acquire timberland. The pension fund that purchased the Adirondack land mentioned above was a European fund. Many funds, like many people, suffered serious hits in their equity accounts last year and now they are looking at assets that are more likely to protect the principle in a down market. And they are willing to accept a lower return to do that. Institutions want to diversify their portfolios, particularly by acquiring hard assets that are perceived to be an inflation hedge. More money chasing fewer acres.

Third, future wood demand for biomass will be impacted by concerns for energy self-sufficiency, renewable energy and global warming. We already have pellet mills built to

export pellets to Europe where they are mixed with coal to reduce the amount of carbon tax that the European utilities must pay. Most forecasters expect to see a similar tax in the U.S. too (perhaps by the time you read this). The higher the price of oil goes, the more wood becomes an economical energy source and the higher the price of wood will go.

Fourth, it is pretty well accepted that declining interest rates have impacted the discount rates used by institutional timberland purchasers. A declining discount rate drives value up!

### ***What would cause prices to decline?***

There was an article in Barron's this past June that said "investors are mispricing timberland as an asset class and Plum Creek as a stock. Our target price is \$10 to \$15 per share, or \$600 an acre." As justification for that comment, the analyst went on to say "timberland values have doubled in five years and nearly tripled in 10". (Figure 3 indicates that timberland values have not quite doubled in the last 10 years). Here are a few things that could cause the Barron's analyst to be correct (along with my thoughts on the probability).

- Pull-out of the timberland market by institutional investors for any reason (low returns, government regulation, etc.); not probable
- Increase in interest rates/ discount rates (what goes up, must come down); very probable
- Less emphasis on the desire to address energy self-sufficiency, renewable energy and the perceived harm of global warming; not probable
- Low oil prices; not probable
- Low inflation: not probable

Overall, the probability that he is correct looks very low to me. But that is why we have markets (and short sellers)!

### ***So what does the future hold?***

We don't know what the future holds and we never will. But here are a couple of things we do know about timberland prices.

- The trend is up.
- The market is softer than it was a year ago.
- There is a huge amount of investor cash sitting on the sidelines that will be invested somewhere.
- More pension funds are increasing their allocations toward timberland.
- Current political/societal issues point to upward pressure on stumpage prices.
- Unlike stocks and bonds, timberland values have never dropped to zero!

No matter what happens, as a forest landowner we can still walk on our land, watch our dog in amazement, hunt a turkey or capture that certain peace that comes from being a part of the woods. And that is a huge part of the return from our timberland investment. I don't know about you, but as for me and mine, we won't be selling.

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The author consults on timberland issues with industry analysts, institutional investors, TIMOs and the forest industry (<http://www.timberlandstrategies.com>). He owns and manages Tree Farms in SC and NY and authors **The Timberland Blog** “*Examining the changes in timberland ownership and what those changes might mean.*”