US FORESTRY FACTS

The National Forestry Picture Reveals a Stable Base

- The U.S. has about 749 million acres of forests of which 504 million (67%) is available for timber production.
- The forest land base has been stable for the past 100 years, and growing stock has increased 39% since 1953.
- Nationally, private forests account for 356 million acres or 48% of total forests.
    - The forest industry owns 16%.
    - About 10 million non-industrial private landowners (NIPF) own 84%.
        - Ninety-percent of NIPF own 100 acres or less.
        - *In Washington, the average ownership size for NIPF is 115 acres, representing nearly 30,000 landowners managing about half of the private forestland in the state.*

Privately Owned Forestlands Provide the Nation's Timber Needs

- Privately-owned forests account for 89% of the Nation's timber production.
- Private forestlands are valued at about $230 billion.

Western U.S. Harvests Show Sharp Declines

- In the West, where harvesting was sharply curtailed from 1987 – 2001, timber harvesting has declined 70%.
- Annual harvest removals are currently about 45% of net growth in the West.
- In the East, where the majority of the land is in private ownership, 88% of net growth is removed annually.

CHANGES IN FORESTRY OWNERSHIP

There has been a fundamental shift in the forestland asset class over the past 20 years – driven by three major developments.

1. The forest products industry has evolved and become more sophisticated.
2. Timber is now recognized as a mainstream financial asset class.
3. New ownership structures emerged due to developments and changes to pension and income tax laws.

The Forest Products Industry Has Evolved And Become More Sophisticated.

Over the past 20 years, vertically integrated forest product companies have faced increased regional and global competition as markets have become more specialized, global trading patterns more sophisticated and margins have declined. To meet these growing competitive threats and pressures, forest products companies have become more specialized and restructured to focus on core product areas through innovation, improved efficiency and cost reductions. For example, a forest products company with timberland and manufacturing facilities may have decided to shed all or part of its land base in order to free up capital and concentrate on its manufacturing activities. Too often, the earnings from the timberlands operation of a vertically integrated company were masked when combined with the overall corporate earnings.

Timber Is Now Recognized As A Mainstream Financial Asset Class

During the 1970s and 1980s, timberland was increasingly used as collateral for loans as large vertically integrated forest products companies expanded their pulp and paper production capacity. This exposed many financial institutions to timber and ushered in greater understanding of the asset class. This gradual evolution coincided with the passage of the ERISA (Employee Retirement Income Security Act) law in 1974 which facilitated investment in timberland through annuity vehicles offered by insurance companies and by tax exempt entities such as pension funds.

Pension funds and insurance companies took advantage in the mid-1980s, of market conditions which had nearly six million acres of land on the market with few buyers. John Hancock Mutual Life Equitable Insurance, Prudential Insurance and Travelers Insurance raised pension fund capital to purchase significant blocks of timberland and began to offer their services as TIMOs (Timberland Investment Management Organizations). They were successful raising capital by pointing out the investment attributes of timberland, namely that it has outperformed the S&P 500 and many asset classes over a long investment horizon while being negatively correlated with equities, bonds and commercial real estate and positively correlated with inflation. These attributes allowed timber to be placed within a portfolio and to provide significant diversification benefits without lowering returns.

Pension funds also found that timber investments, in addition to providing solid long-term performance, were well aligned with future financial obligations. Through tax-efficient ownership vehicles offered by TIMOs, timberland is now more accessible to institutions, large public and private pension funds, university endowments and charitable foundations.

New Ownership Structures Emerged Due To Developments And Changes To Pension And Income Tax Laws

Prior to the mid-1980s there was virtually no ownership of forestland by institutions, pension funds, university endowments and charitable organizations. Today, these types of organizations have more than $13 billion dollars invested in timberland. This shift in timberland ownership should continue because the forestland asset class is more accessible to both the institutional and the individual investor.

Beginning in the mid-1980s, tax efficient master limited partnerships (MLPs) emerged as owners of timberland. These entities, most of which were spun out of publicly traded C-Corps, provided their public unit holders with a tax efficient flow through vehicle for owning timber. They benefited from having capital gains treatment on timber income and did not pay a corporate tax. Instead, their unit holders received a "K-1" which consisted of their pro-rata share of the partnership's income.

In 1999, Plum Creek Timber abandoned their MLP structure and converted to a publicly-traded REIT (Real Estate Investment Trust) which reports its dividends on the commonly used 1099 form. Initially there was difficulty in qualifying the conversion of forest assets to a REIT because of tax consequences. However, in 2001 a Revenue-ruling clarified the tax treatment of transferring timberland to a REIT thus opened the door for other timber REITs to be formed. Today, there are four publicly traded timber REITs as well as a few private timber REITs. For individuals, the publicly-traded timber REIT provides investors easier access to an asset class that historically has outperformed the S&P 500.

Today there are three broad classes of private ownership of timberland:

1) Family Forest landowners (non-industrial private forestland owners)
2) Institutional and investment owners (financial owners)
3) Publicly-traded and privately held timber companies (strategic owners)

Timberland investors participate in income generated by timber sales and other property-based activities, such as

- the sale of hunting and recreational leases;
- granting of mineral, oil and gas rights; and
- the sale of development rights to commercial and residential buyers, government entities and conservation groups.

These alternative sources of income buttress the returns associated with harvest income and serve as an important component of a timber parcel's annual return. Much of the overall return from owning timberland comes from the annual volume and value growth in this renewable asset. In addition, value can be stored on the stump in down markets by allowing trees to continue to increase in value through time.

Forestland, as an investment, has some unique attributes not found in other types of investments:

- Its negative correlation to most stocks and bonds provide portfolio diversification.
- Historical real price appreciation for land and timber provide a hedge against inflation.
- Periodic cash income is available at the owner's option – making the investment analogous to periodic bond income.

But nothing mandates harvest. If log markets are poor, harvest can be delayed until such time as prices improve. During this interval, while the owner awaits price improvements, the trees are increasing in size due to annual growth. It is a hard asset – they aren't making any more land. And finally, as most any family forest landowner will confirm, there is a high degree of ownership satisfaction: you can hunt on it, fish on it, live on it, or just look at it.

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