TIMOs and REITs: The new face of industrial forestry

Samuel J. Radcliffe, Prentiss & Carlisle Forestry

Introduction to P&C

• 1.5 million acres under management
• consulting / due diligence
• woods operations division
• centralized wood marketing

Overview of Presentation

• Timberland Ownership Overview
• The Big Ownership Shift
• Buyers and Sellers
• Some Unintended Consequences

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Timberland Area by Region

Ownership Breakdown

The Big Shift

- Ownership of US industrial forests has almost completely shifted from large forest products corporations to pure timber investment-oriented buyers.
- Since 1996, forest products corporations have shed ~40 million acres of timberland.
- The recent sale of MeadWestvaco timberlands (~500K acres) to Plum Creek represented the “final nail in the coffin.”
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Where?

- South & PNW led the way in early 90’s
  - focus on softwood plantations almost exclusively
  - easy model for investors to understand
  - intensive management regimes and high ROI’s
  - data-rich (growth & yield, prices)
  - abundant deal opportunities
- Northeast (Maine)
  - TIMO industry is Boston-based
  - large private ownerships abundant
  - low bare land prices
- Lake States, Mid-Atlantic last in line
  - hardwoods not as well understood
  - "data-poor"
  - limited universe of deals

The Lake States Shift

<table>
<thead>
<tr>
<th>1999</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>TIMO</td>
<td></td>
</tr>
<tr>
<td>REIT</td>
<td></td>
</tr>
<tr>
<td>Large Private</td>
<td></td>
</tr>
<tr>
<td>Industry</td>
<td></td>
</tr>
</tbody>
</table>

Questions

Who are the buyers?

- Timber Investment Management Organizations (TIMO’s)
  - largest group of acquirers
  - intermediary for institutional investors
  - typically pure equity investors
- Real Estate Investment Trusts (REIT’s)
  - publicly traded
  - more common in commercial real estate; only four major timber REITs
- Private Investors
  - experienced in timber business
  - may be highly leveraged
- Conservation Groups (TNC, TCF, TPL, etc.)
  - may buy directly or in concert with timber investor
  - may hold easement or sell to public agency

Why?

- Sellers (integrated forest products C-corps)
  - Wall Street pressure to improve returns -- timberland sales provide capital for higher return investments, debt reduction, shareholder return
  - Tax laws create double taxation and eliminate cap gains treatment of timber income
  - GAAP prevents reporting of unrealized gains
  - Management sometimes sub-optimized to support mills
- Buyers ("pure" timber investors)
  - Employee Retirement Income Security Act (ERISA) 1974 mandated diversification of pension portfolios
  - IRS ruling 1999 allowed timberland to be held in a REIT
  - Tax exempt or tax-advantaged status
  - Timberland investment characteristics fit portfolio needs

Investment Characteristics

- Return on investment
- Non-correlation with other investment types
- Inflation hedge

Competitive Returns

“She ain’t what she used to be!”


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Non-Correlation

Inflation Hedge

The Major Timber REIT's

<table>
<thead>
<tr>
<th></th>
<th>Market Cap ($ billion)</th>
<th>Acres (millions)</th>
<th>Market Cap Per Acre</th>
</tr>
</thead>
<tbody>
<tr>
<td>Plum Creek</td>
<td>$ 7.86</td>
<td>6.8</td>
<td>$1,156</td>
</tr>
<tr>
<td>Potlatch</td>
<td>$ 1.65</td>
<td>1.4</td>
<td>$1,179</td>
</tr>
<tr>
<td>Rayonier</td>
<td>$ 5.25</td>
<td>2.7</td>
<td>$1,944</td>
</tr>
<tr>
<td>Weyerhaeuser</td>
<td>$ 18.08</td>
<td>6.9</td>
<td>$2,620</td>
</tr>
<tr>
<td>TOTAL</td>
<td>$ 32.84</td>
<td>17.8</td>
<td>$1,845</td>
</tr>
</tbody>
</table>

Some of the Major TIMO’s (2-3 million acres each)

- Campbell Group
- Forest Investment Associates
- Forestland Group
- GMO Renewable Resources
- Hancock Timber Resource Group
- Molpus Woodlands Group
- Resource Management Service
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Who invests with TIMO's?

Funds vs. Separate Accounts

TIMO Investment by Region

TIMO Investment Structure

SOURCE: TimberLink http://www.timberlink.net

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Questions

Unintended Consequences

• Management intensity
  – increased emphasis on cost control
  – fund life can have impact
  – TIMO’s take both intensive and passive approaches

• Timber supply
  – company-owned wood had been the cheapest source
  – investor class motivated to time harvest with markets
  – timber supply agreements smooth the transition to 0% controlled wood

Unintended Consequences

• Ownership fragmentation
  – both immediate and creeping
  – the higher the price paid, the more likely is parcelization
  – conservation easements can address problems

• Conservation easements
  – accelerated trend
  – for investor, avoids UBTI hassles
  – creates more pure timber play on re-sale
  – devil is in the details

Unintended Consequences

• Forestry R&D
  – the investor class supports R&D less than forest products corporations
  – loss of input to research agenda could trickle into curriculum decisions

• Forest certification
  – becomes cost of doing business
  – institutions wary of getting an environmental “black eye”
  – corporations invented and favored SFI
  – new investors seem to favor FSC
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**Trends to watch**

- Investor entities trading among each other
- International investments take prominence
- Off-shore investors come to US
- Continued ownership fragmentation
- Tension between timber supply/prices and industry profitability
- TIMO industry consolidation

**Questions**

**Contact**

Samuel J. Radcliffe  
Vice President  
Prentiss & Carlisle  
2912 East Belleview Place  
Milwaukee, WI 53211  
Voice: 414.964.6400  
Email: sjradcliffe@prentissandcarlisle.com

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