

# Domestic Timber Investments

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Bob Saul



# Presenter

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**Robert Saul** Mr. Saul is the Director of Northern Hemisphere Investments for GMO RR and is responsible for all U.S. and Central American investments in client portfolios. He joined GMO RR in 1998, and is primarily responsible for a portfolio of properties located in all major wood growing regions of the United States as well as Costa Rica and Panama. Prior to joining GMORR, Mr. Saul established the first large scale hardwood plantations in New England. He earned his B.A. in English from Amherst College and an M.P.P. from Harvard University.

## ***Domestic Timber Investments:***

- How?

- Where and When?

- What Happened and Why?

and

- Why not now?



# How?

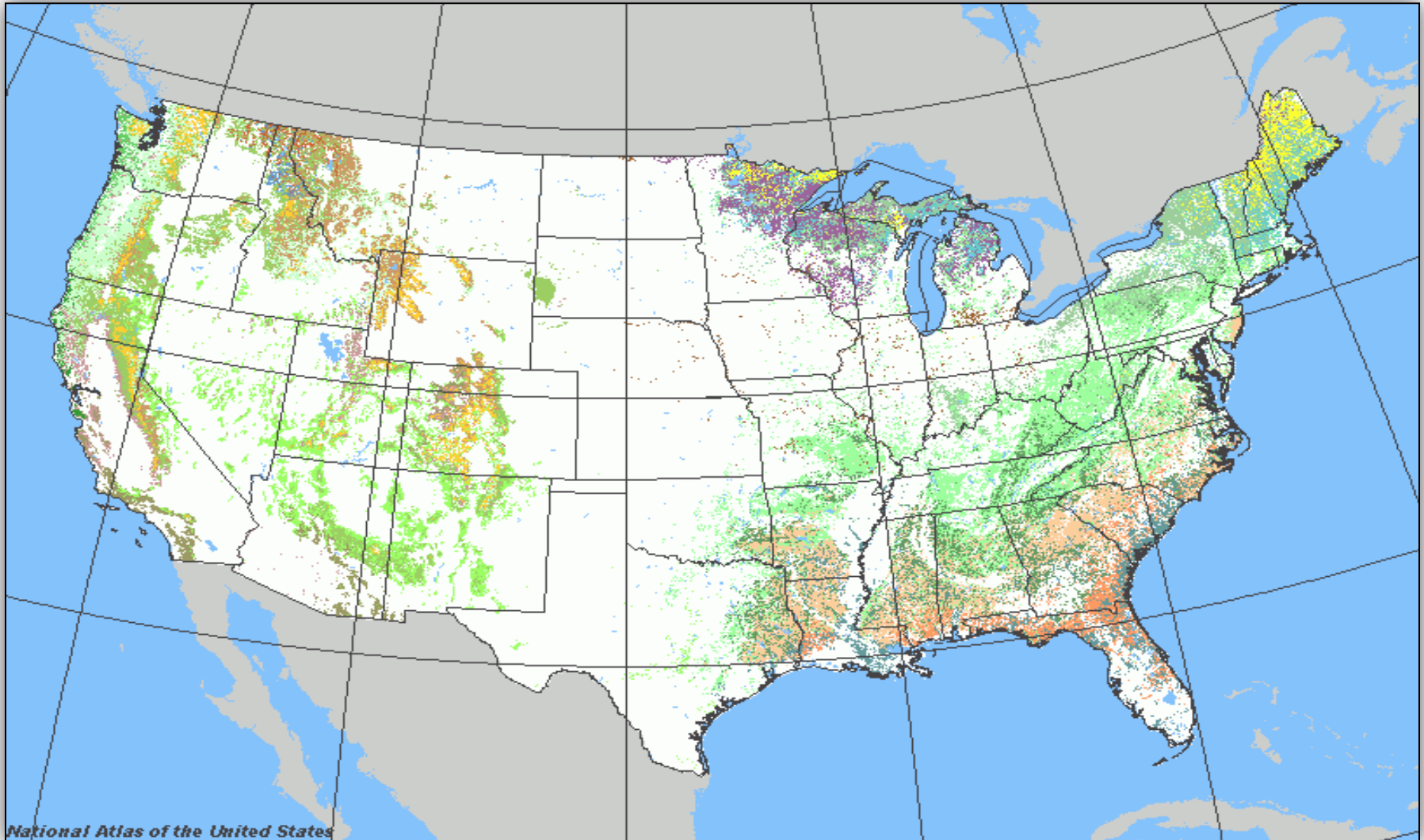
## The Basics: Factors Used to Assess Timberland Value

1. Magnitude and timing of expected cash-flow
2. Security of expected cash-flow
3. Duration of growing season
4. Property carrying costs
5. Flexibility of land use
6. Operability of land base
7. Site productivity
8. Transportation Options
9. Market Diversity
10. Country risk



# Where?

*The U.S. Timberland Universe:  
350 million forested acres in the United States*



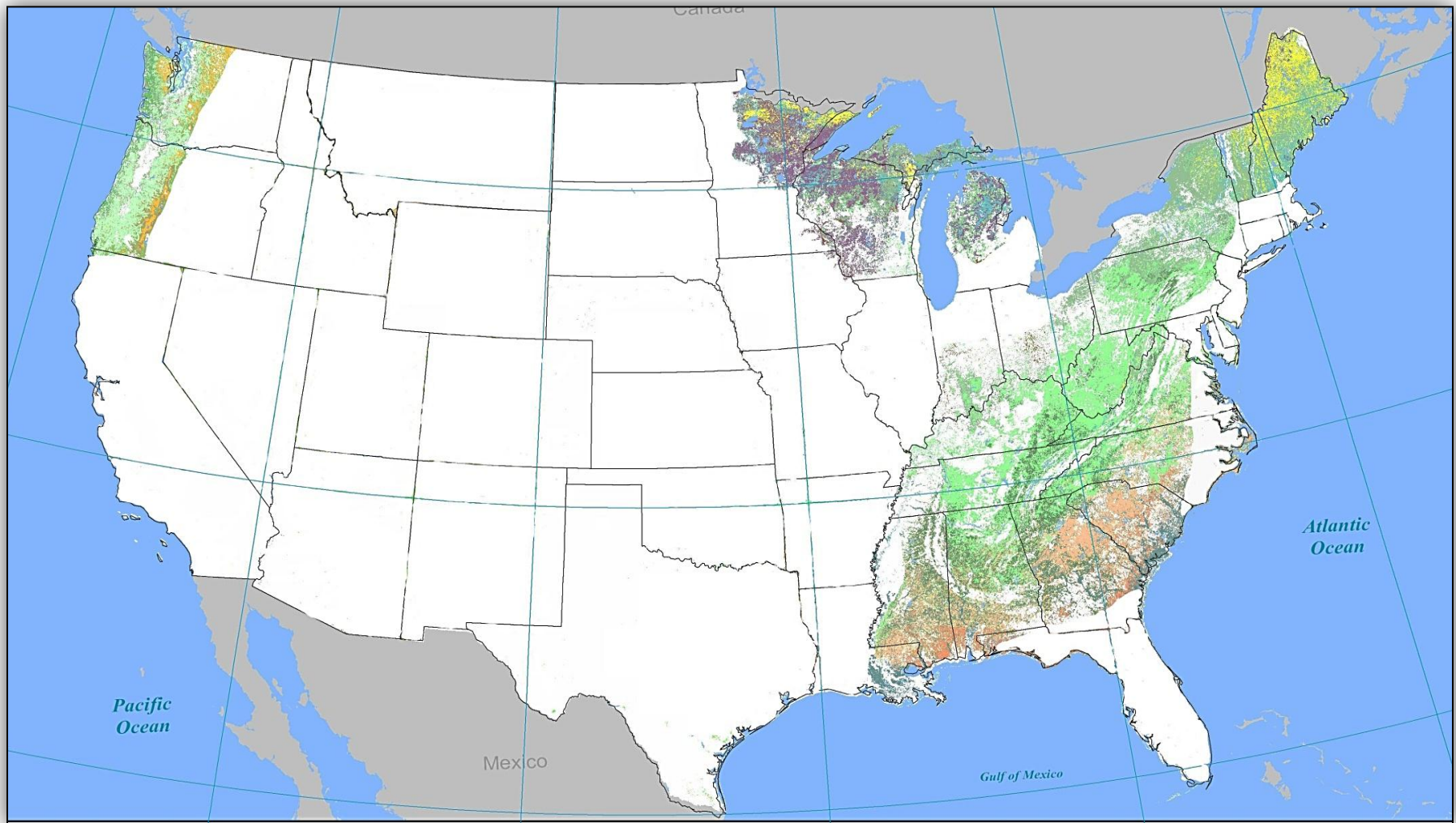
# Then Subtract

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- California
- Public lands
- Low Rainfall and Slow Growth Regions and Species
- Inactive or non-competitive Stumpage Markets
- Regions that are vulnerable to Climate Change
- Regions that are population dense (HBU intensive)

# And you get about 210 Million Private Forested Acres

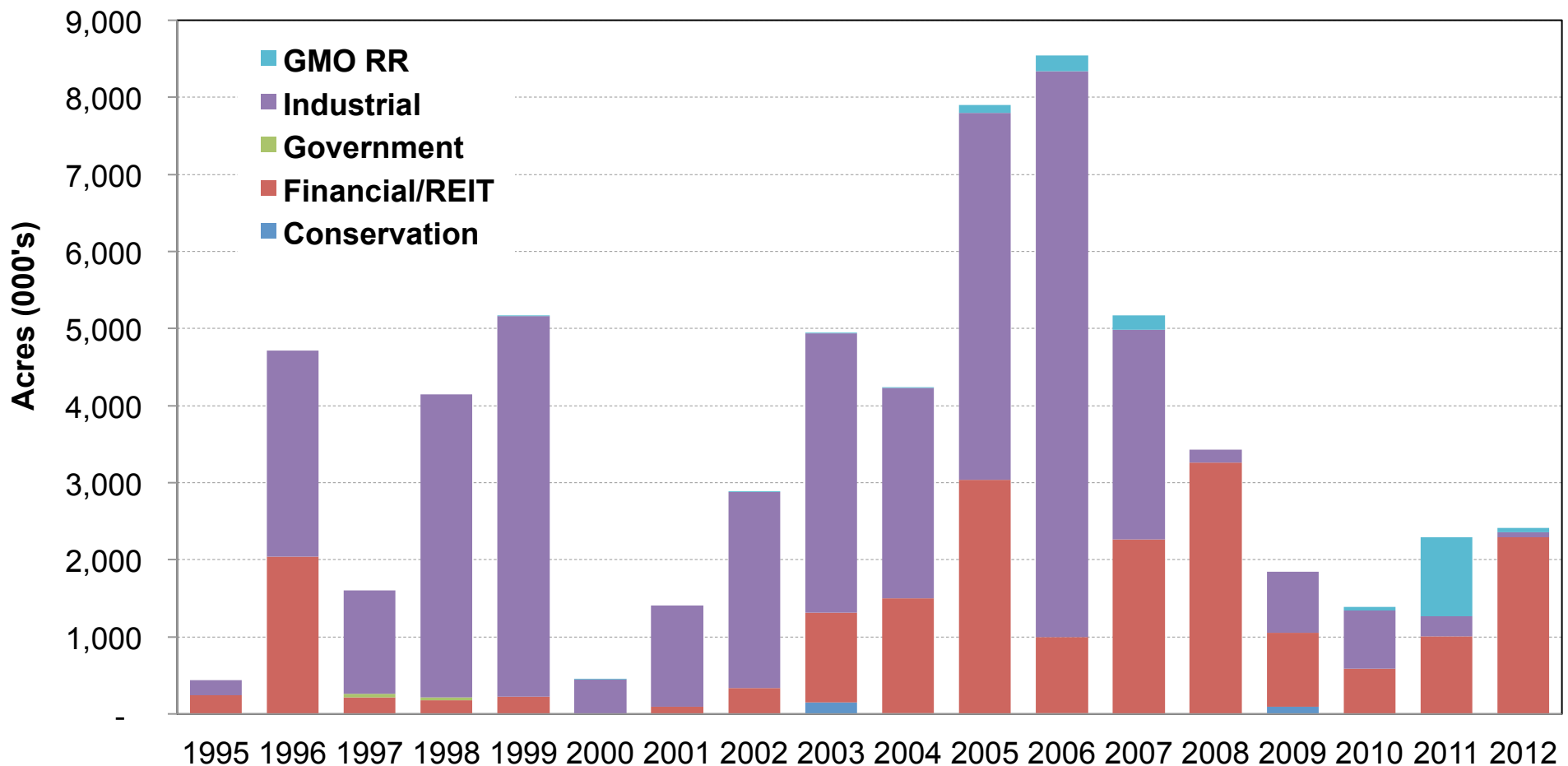
*Total market cap of about \$100 billion*



# When?

*A brief history of recent market activity: Industry Selling*

## U.S. Timberlands Transactions by Seller Type

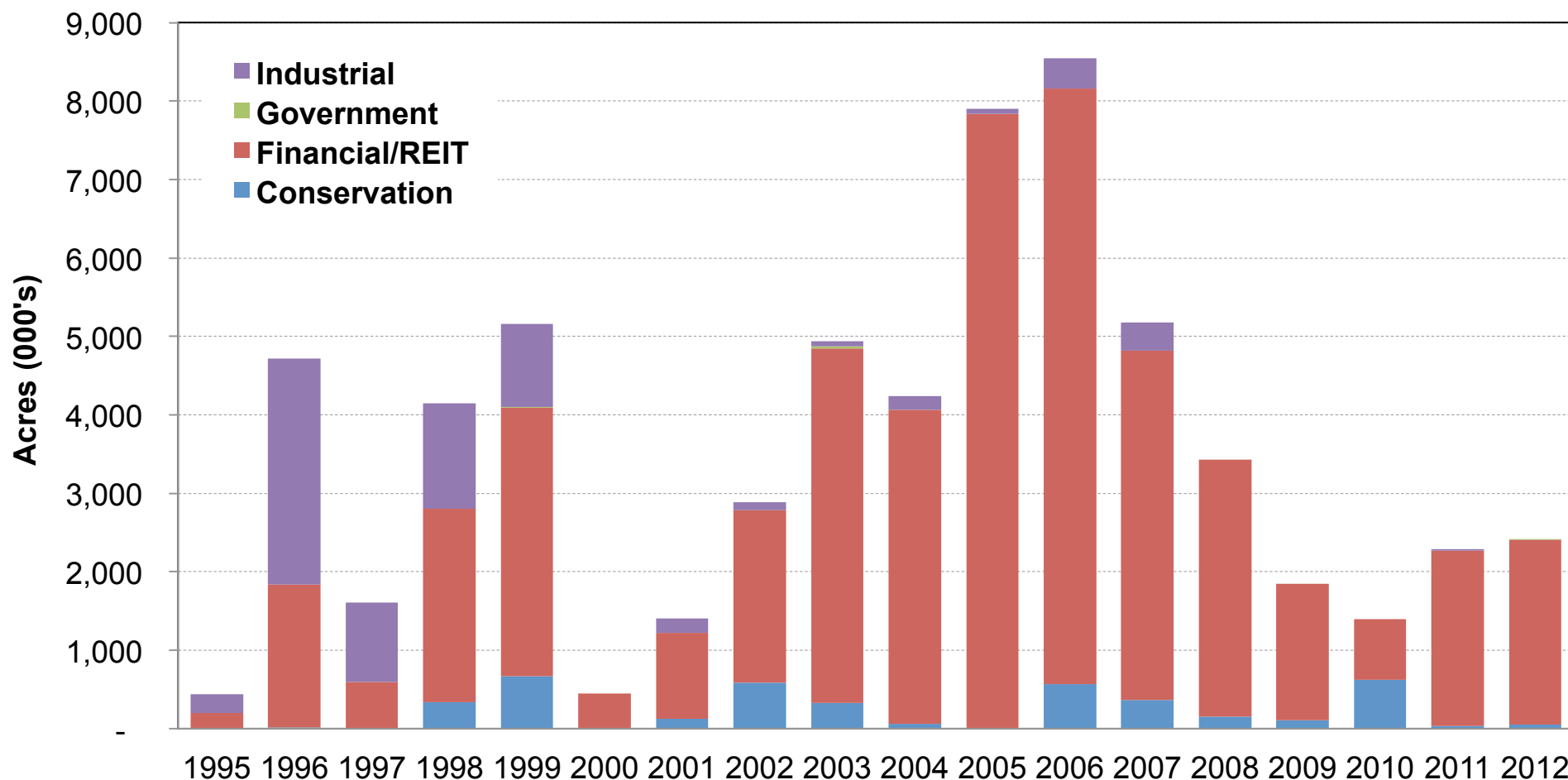


*70% of legacy industrial acres changed hands between 1996 and 2007*



# Financial Investors and REITs Buying

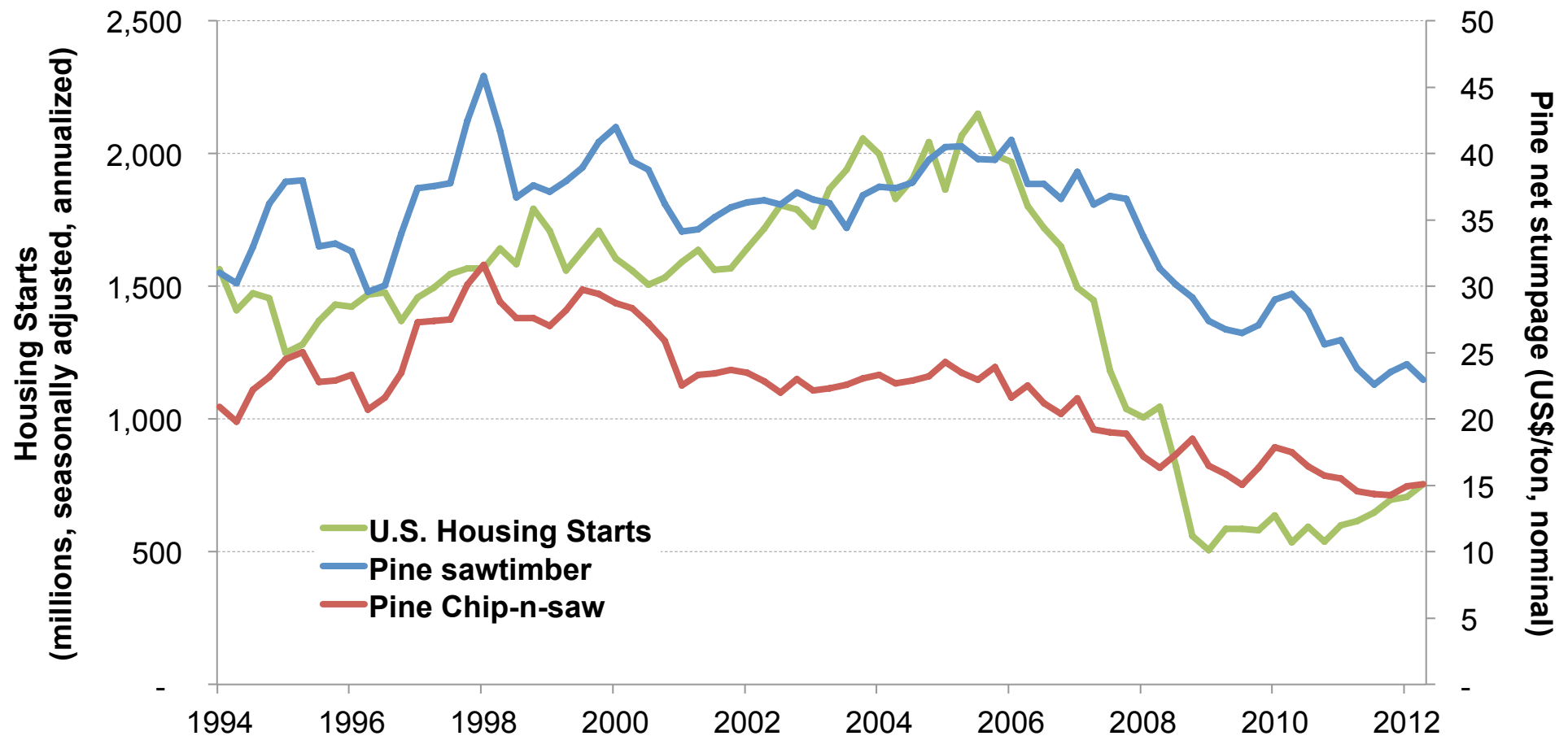
## U.S. Timberlands Transactions by Buyer Type



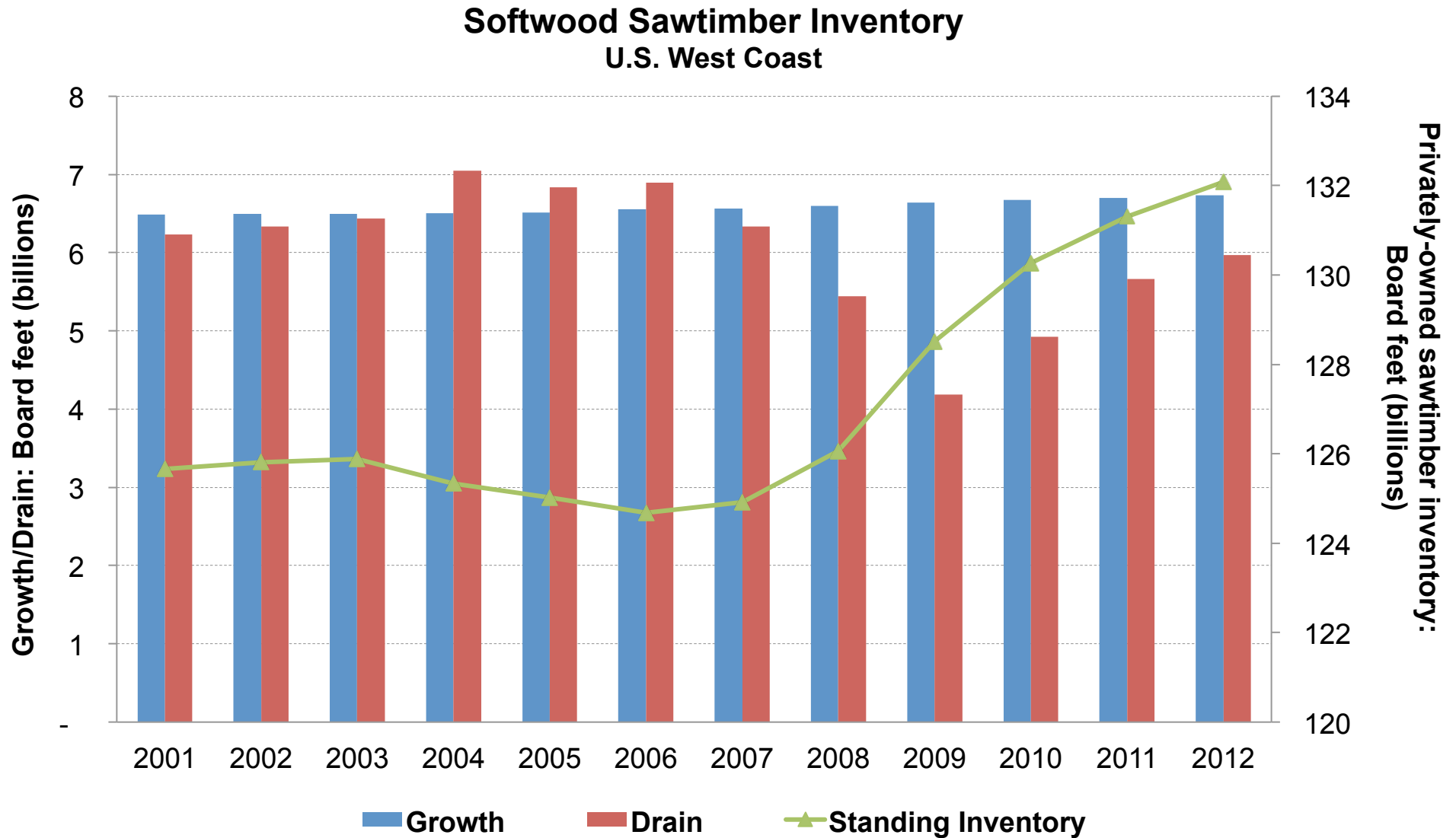
# What happened?

*Housing starts decline and log prices follow*

**Housing Starts vs. Southern Pine Log Prices**



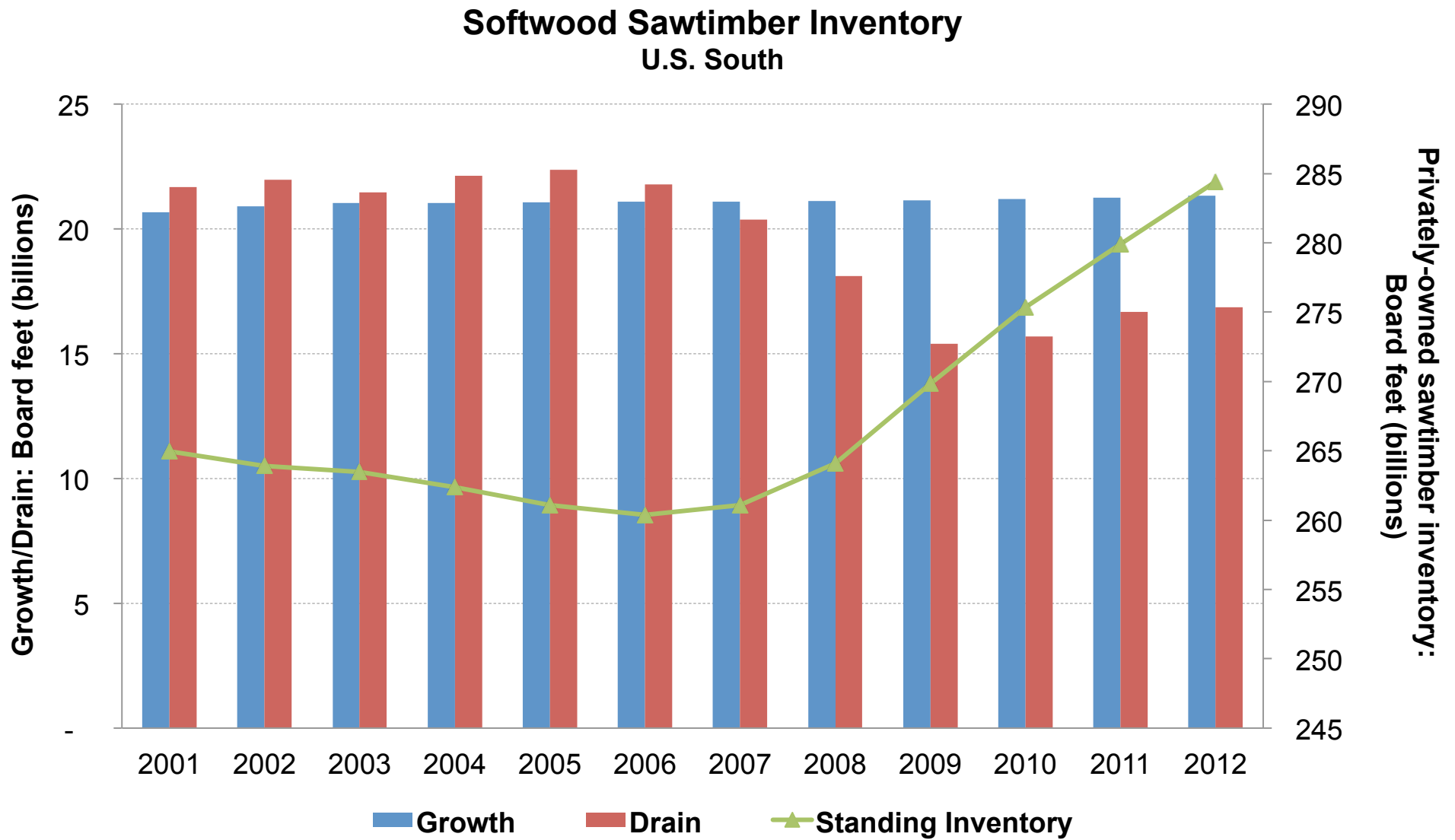
# U.S. Timberland Growth vs. Drain



Note: "Drain" is harvest and loss to HBU conversion



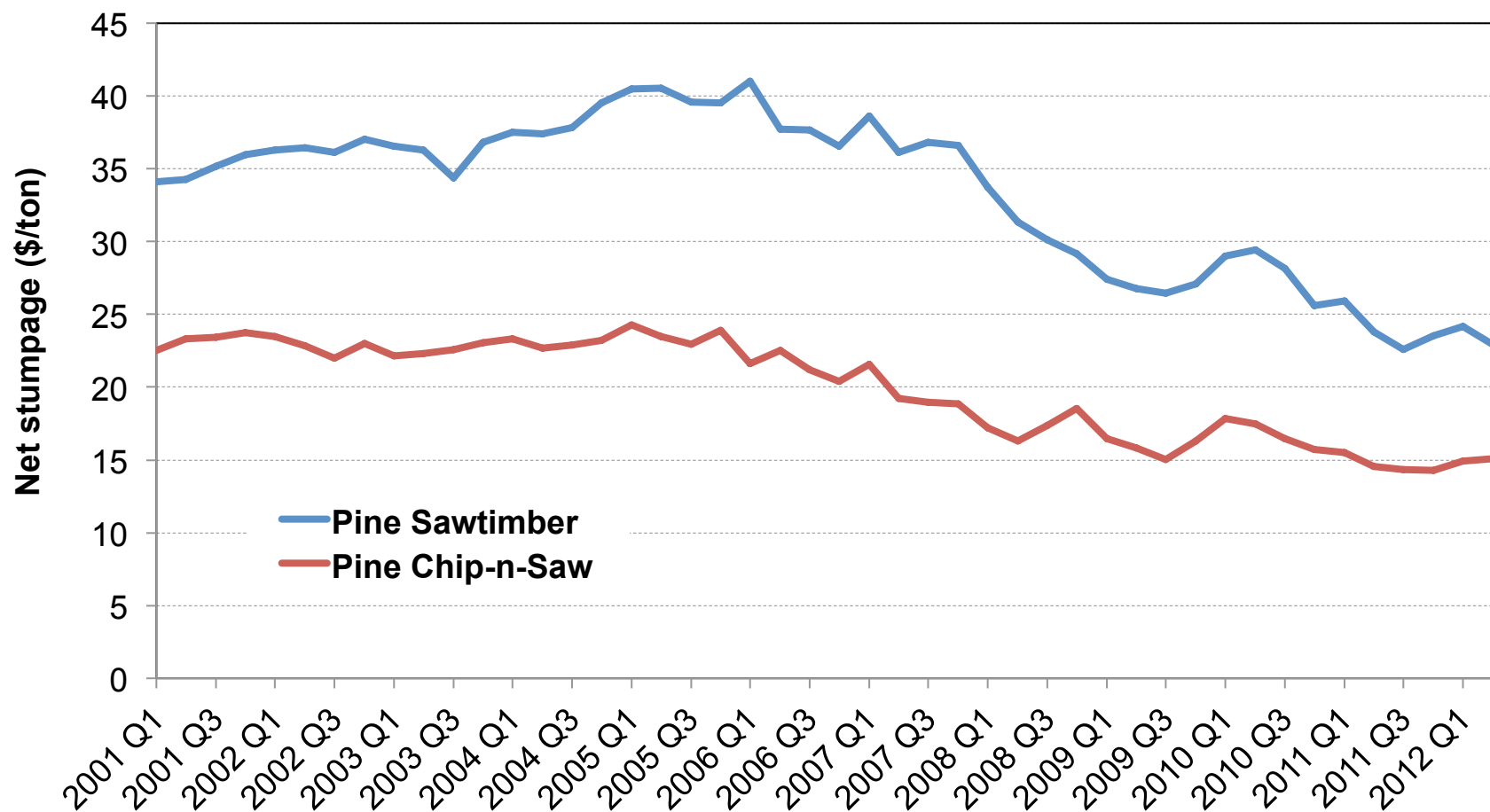
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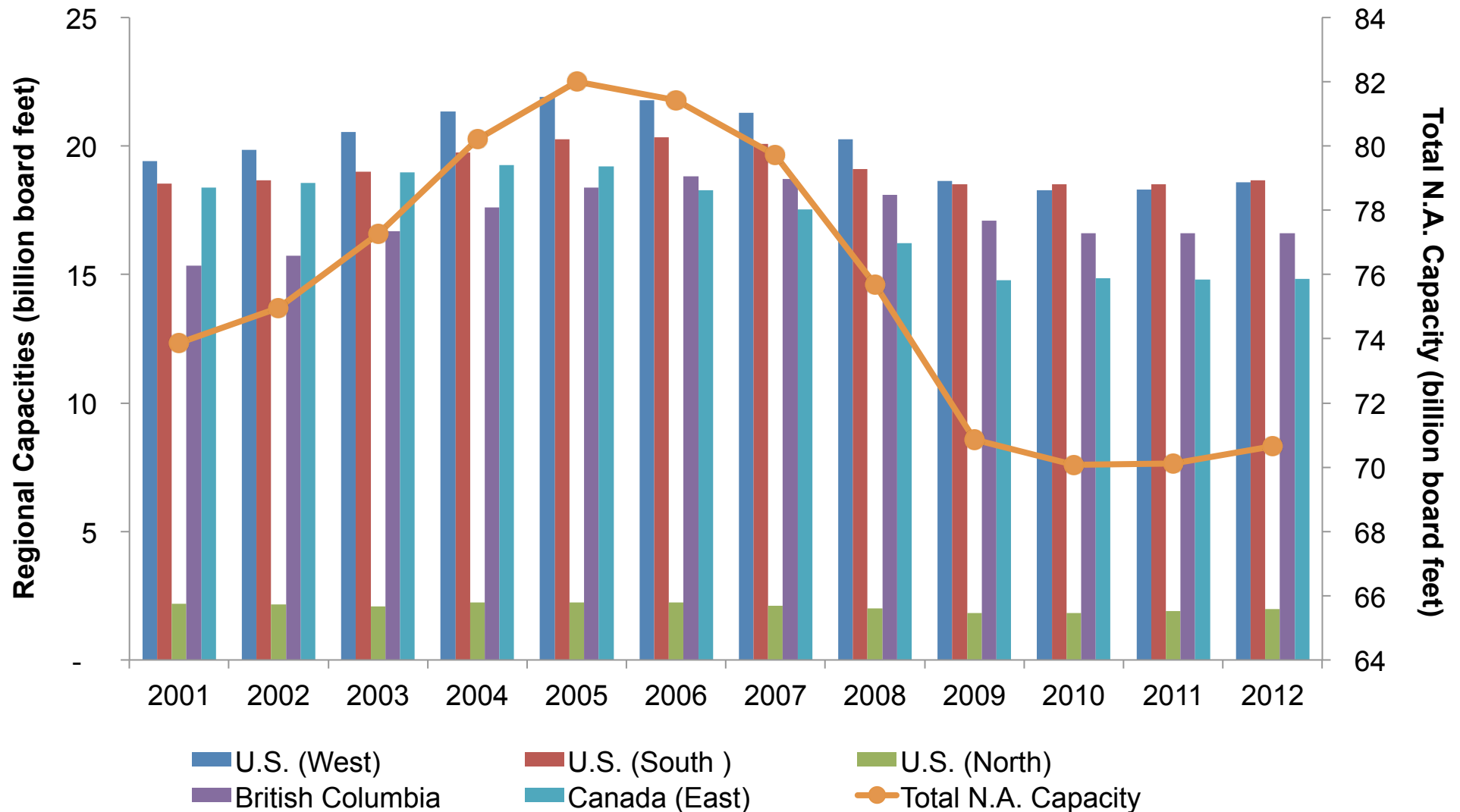
# Southern Pine Prices

**Southern Pine Prices : Regional Avg.  
(2001 to Q2-2012)**



# North American Processing Capacity: SW Lumber

North American Softwood Lumber Capacity by Region (2001-2012)



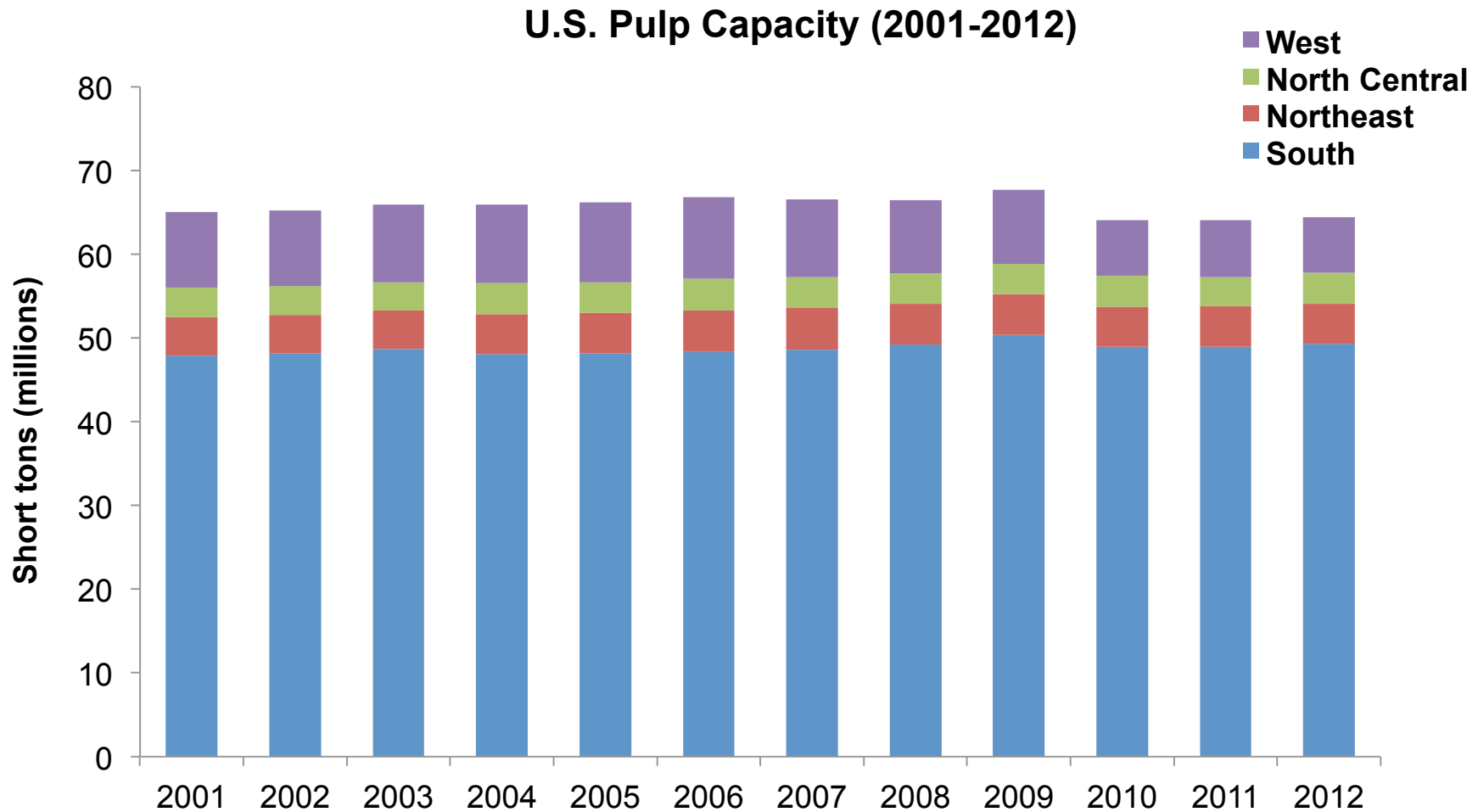


# North American Processing Capacity: Plywood

North American Plywood Capacity by Region (2001-2012)

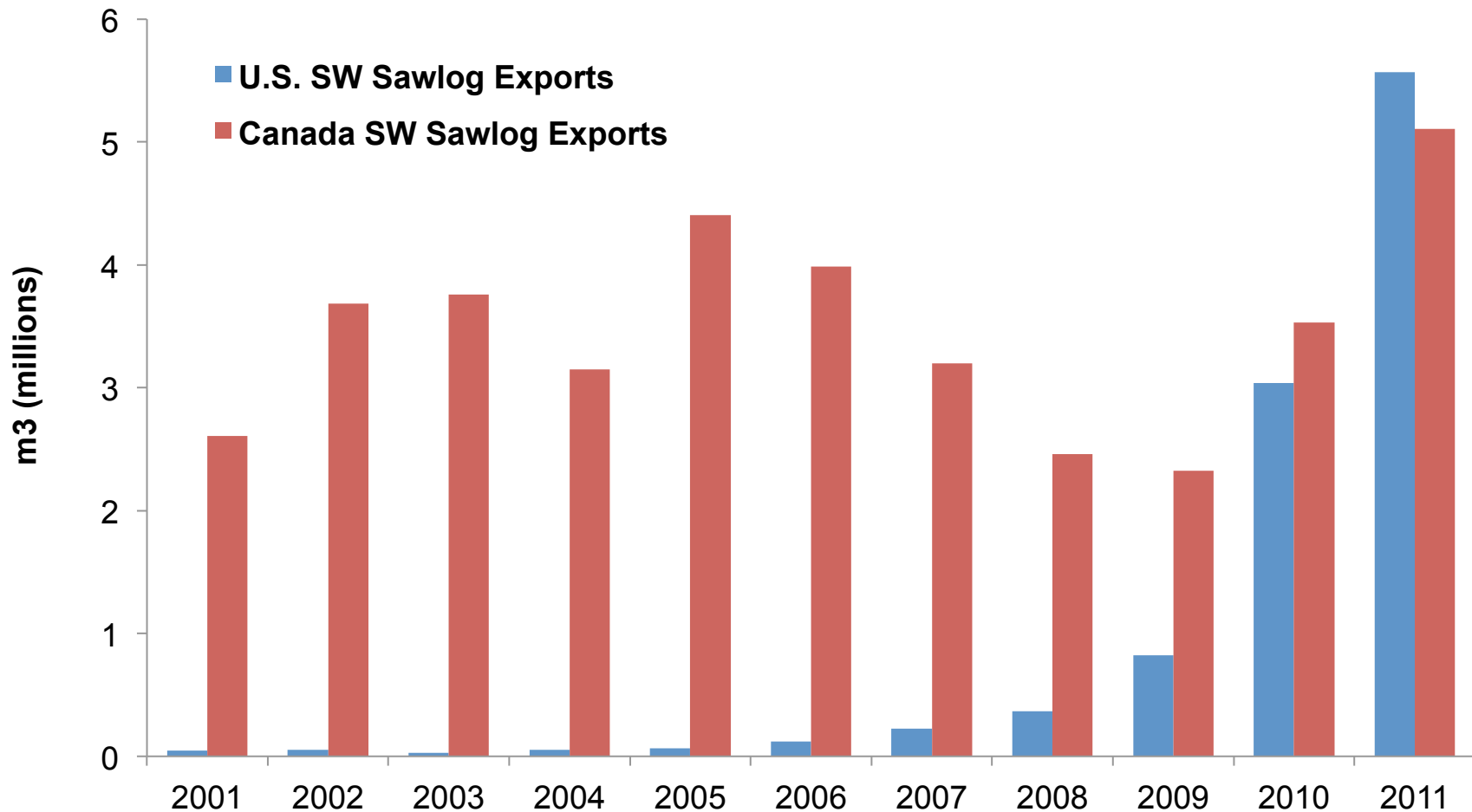


# North American Processing Capacity: Pulp



# Softwood Sawlog Exports: North America

U.S. & Canada SW Sawtimber Exports (2001 - 2011)





# Today's Market for Timberland Assets

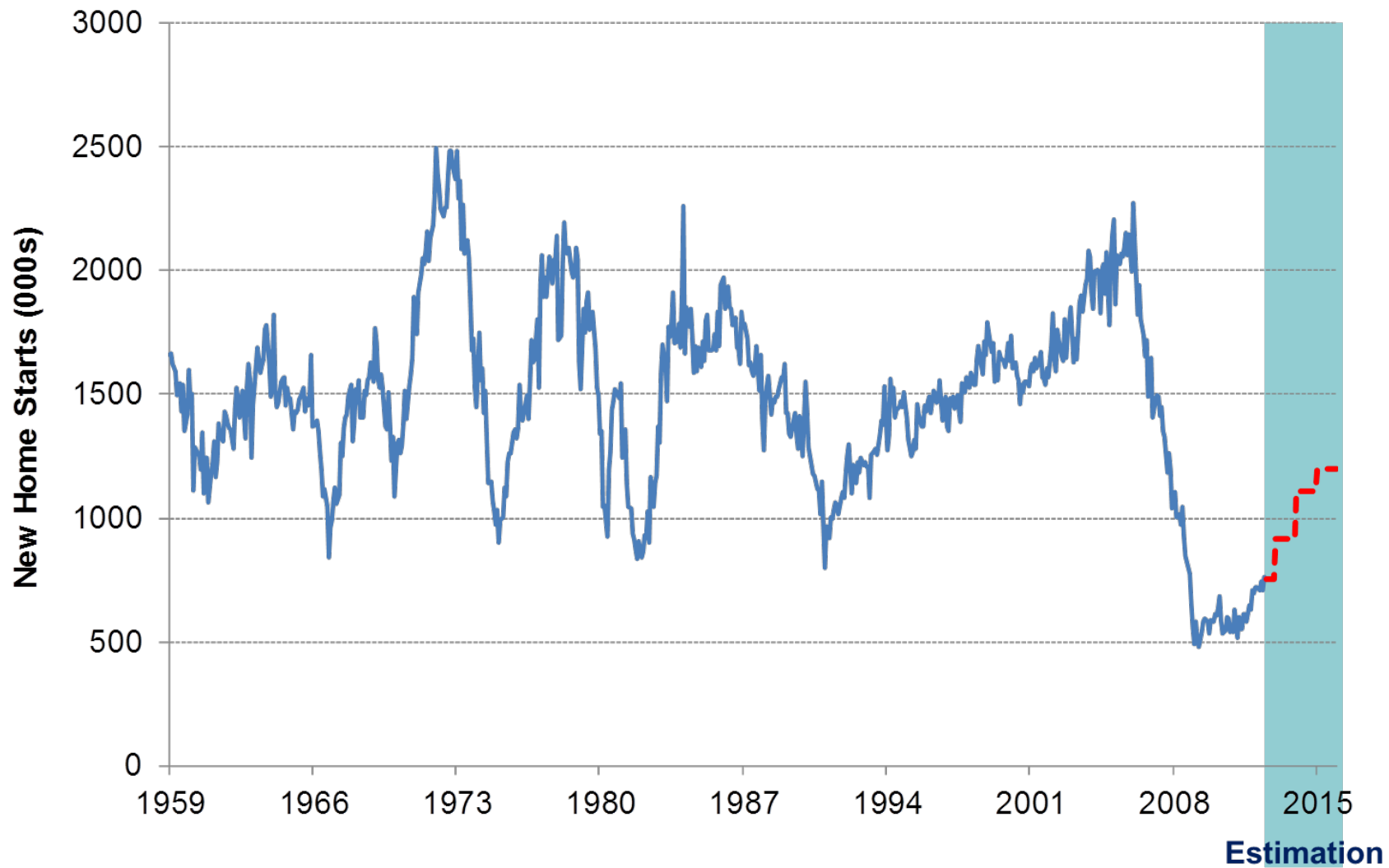
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- Disconnect between buyers (7% + discount rate) and sellers who sit on “market-based” or, internal appraisal valuations using discount rates at or below 5.5%
- Transaction sizes MUCH smaller than the “great monetization” of 2002 to 2008
- Hard to place significant institutional capital efficiently
- Very little transactional data available to help read the market
- More difficult to do a deal with a financial seller/buyer combination than an industrial/financial seller/buyer combination

Why it is too early to invest in U.S. timberland?

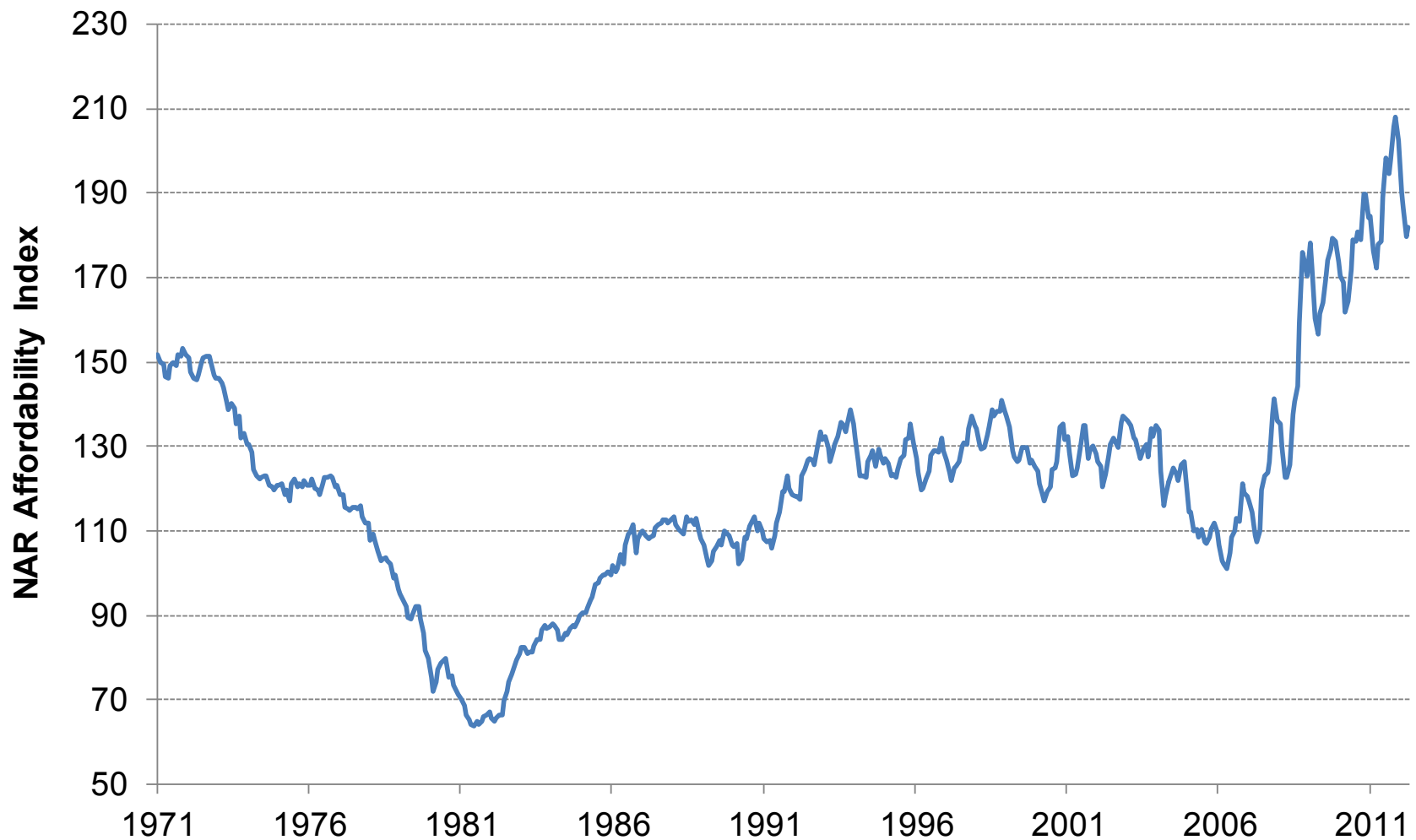
All Eyes Turn to the U.S. Housing Market

# Consensus Anticipates a Strong Recovery in Housing Starts

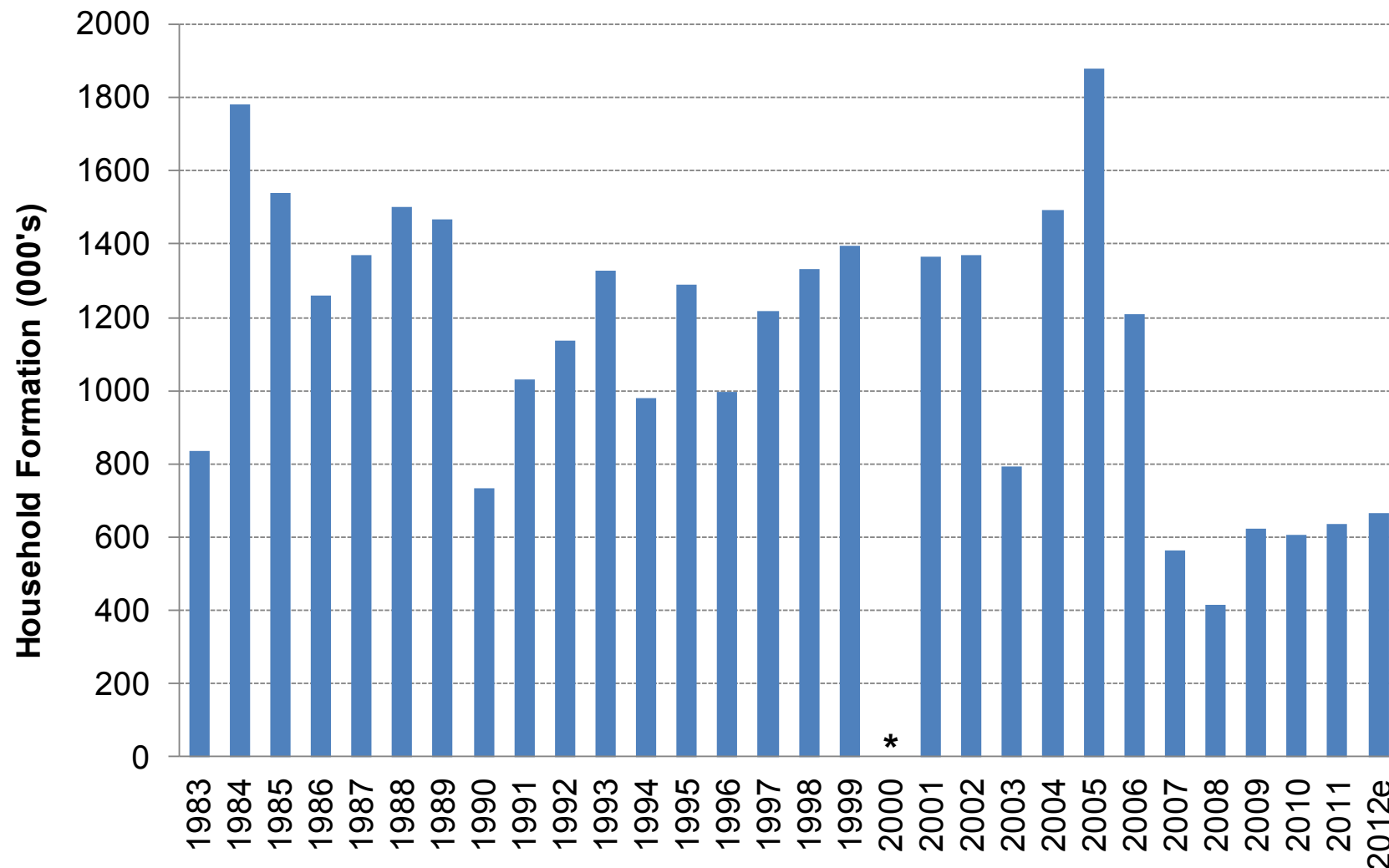




# Affordability is Near Record Highs

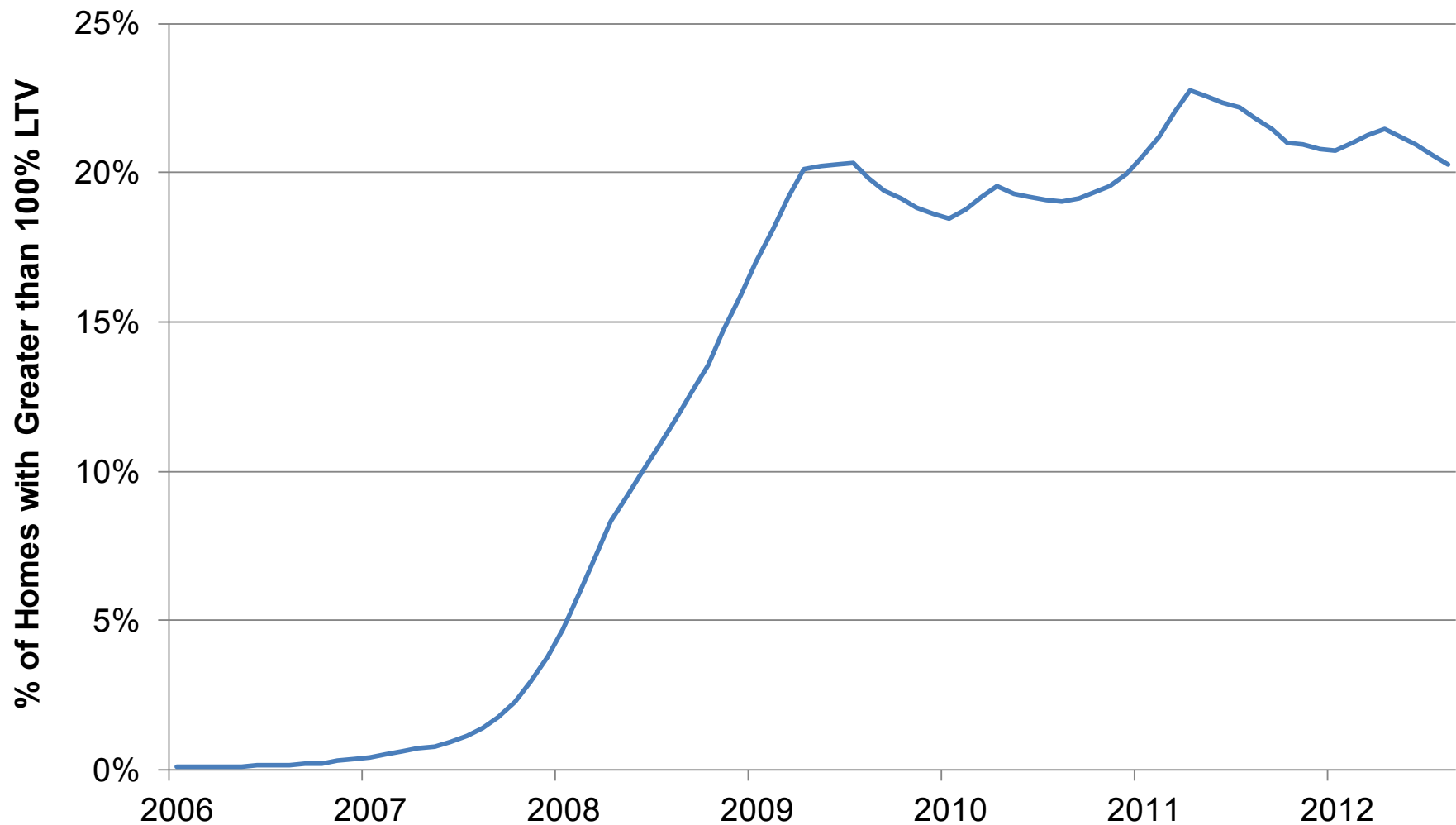


# But Household Formation Remains Well Below the Long-Term Average

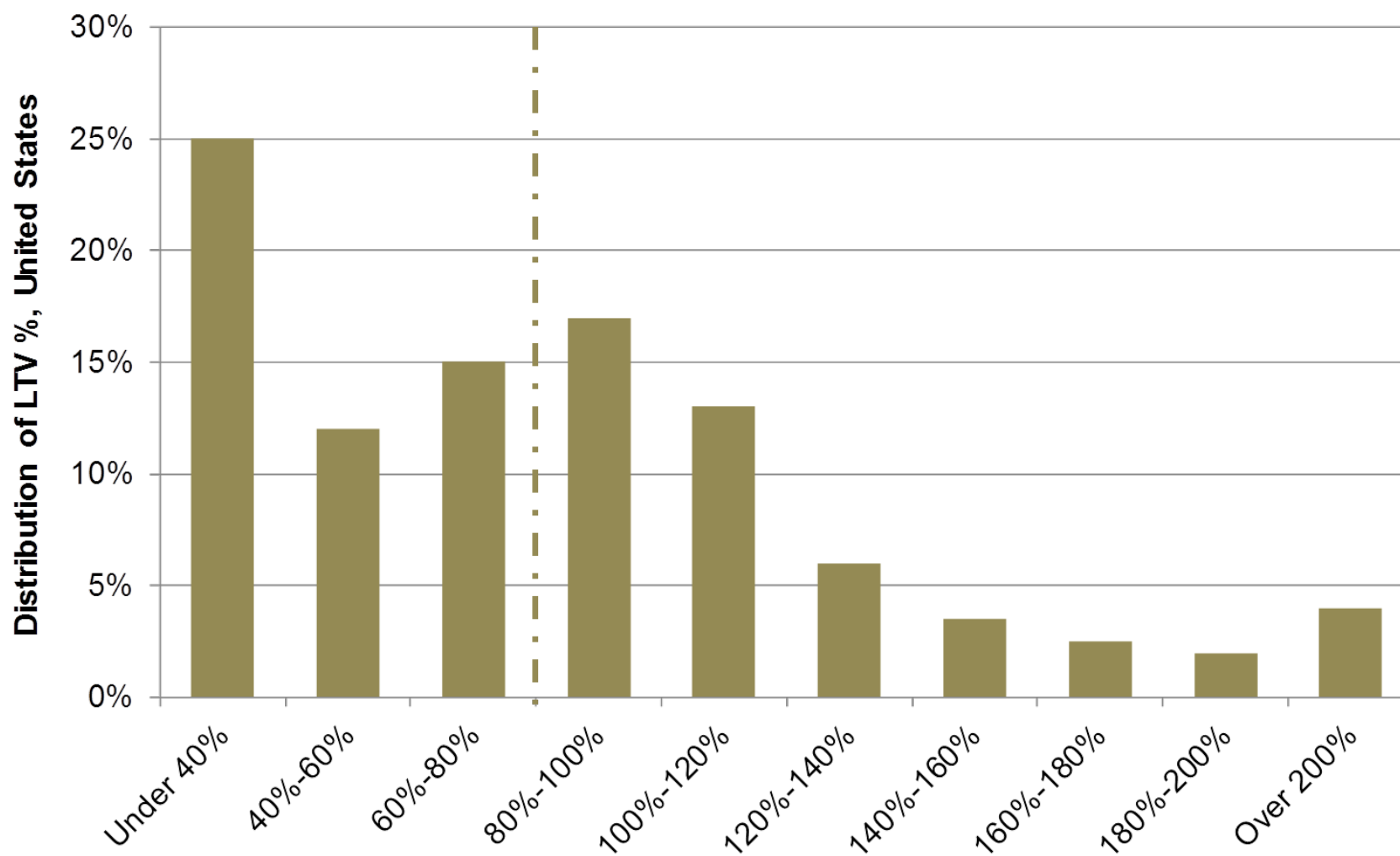


\*Note: Estimates for household formations are not included where adjacent years are non-comparable.

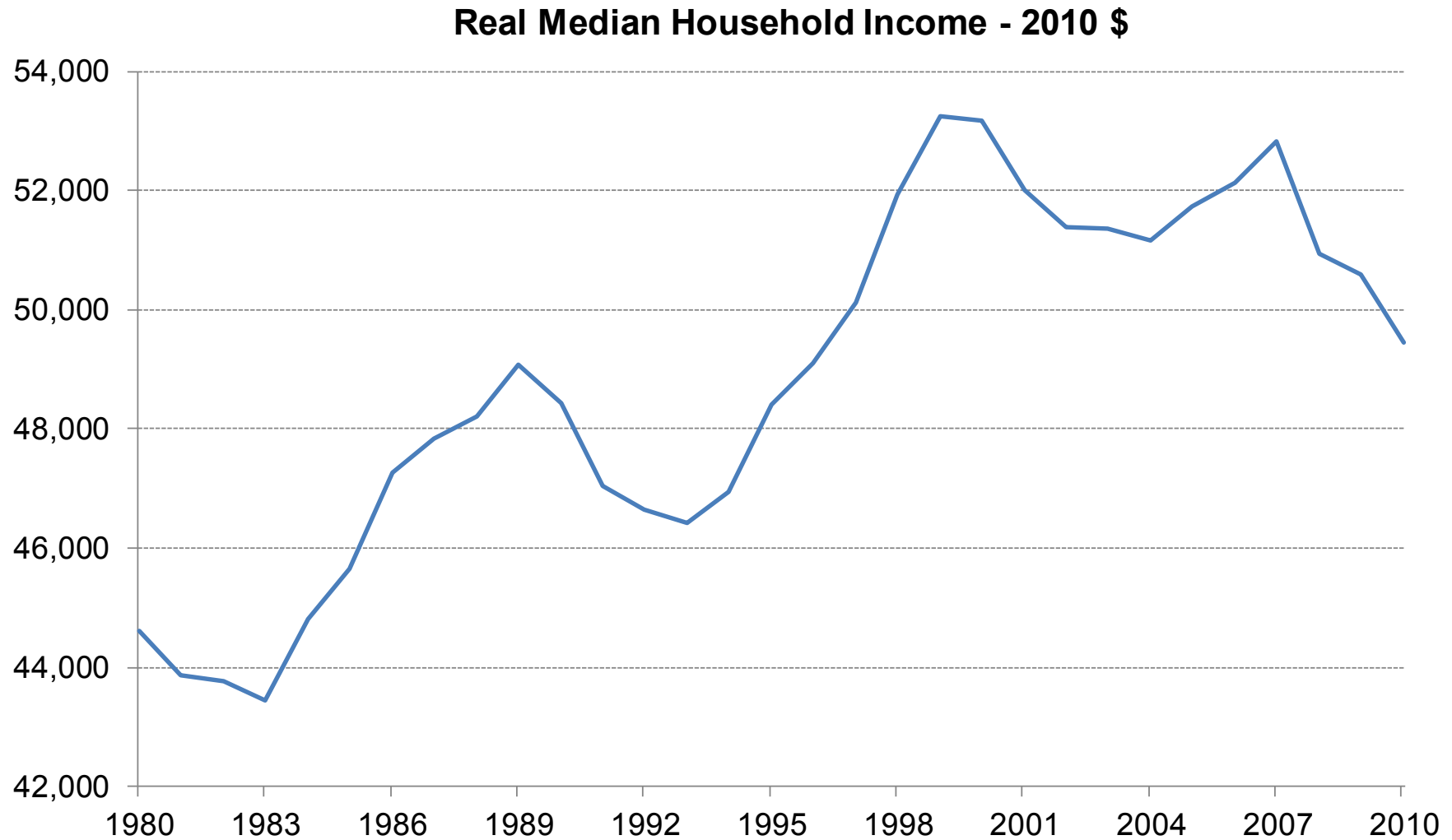
# A Fifth of all Homes are Still Underwater



# For Over 40% of the Population, Selling the House Doesn't Make Financial Sense

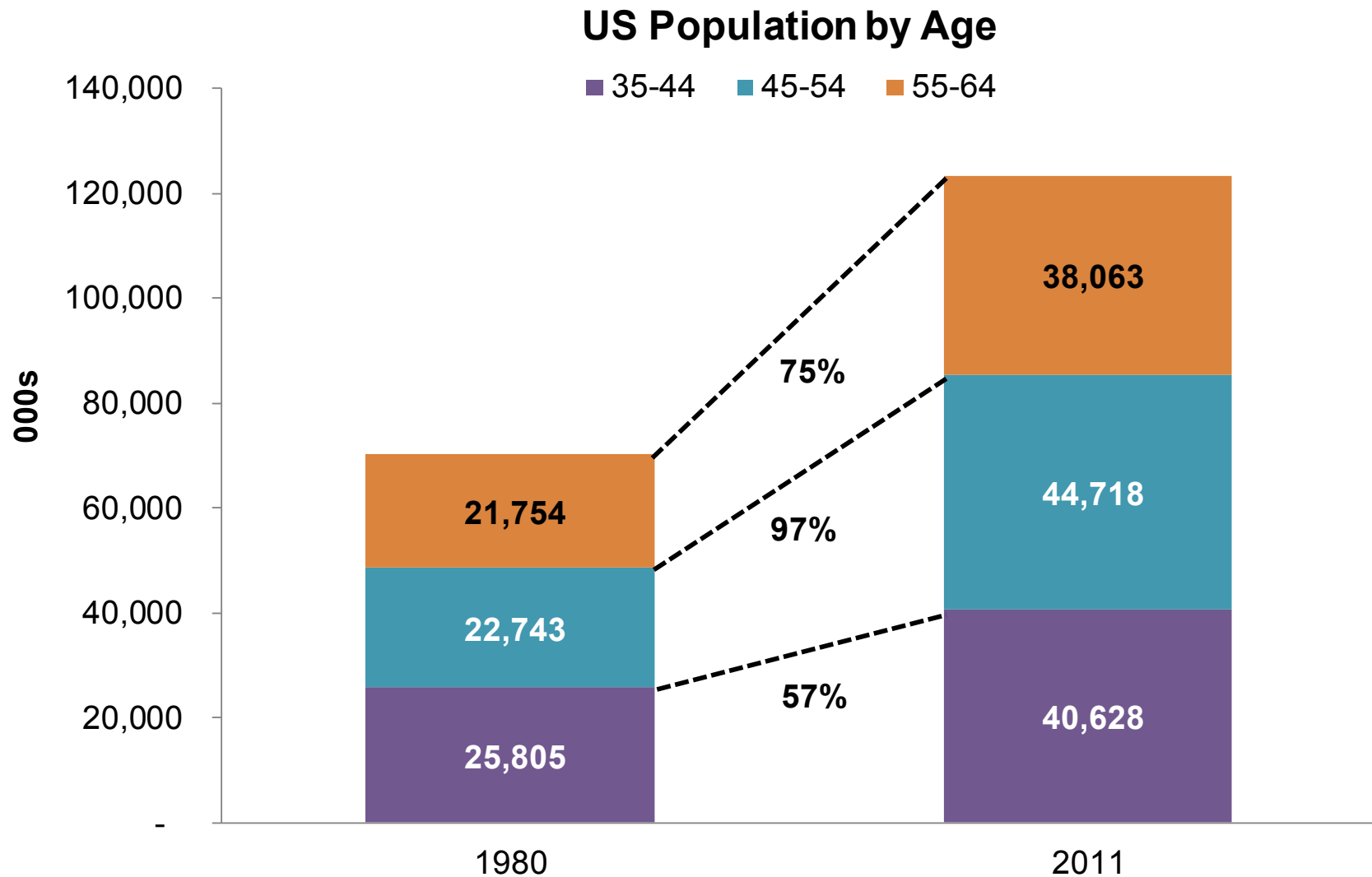


# Rising Incomes Supported Housing Demand

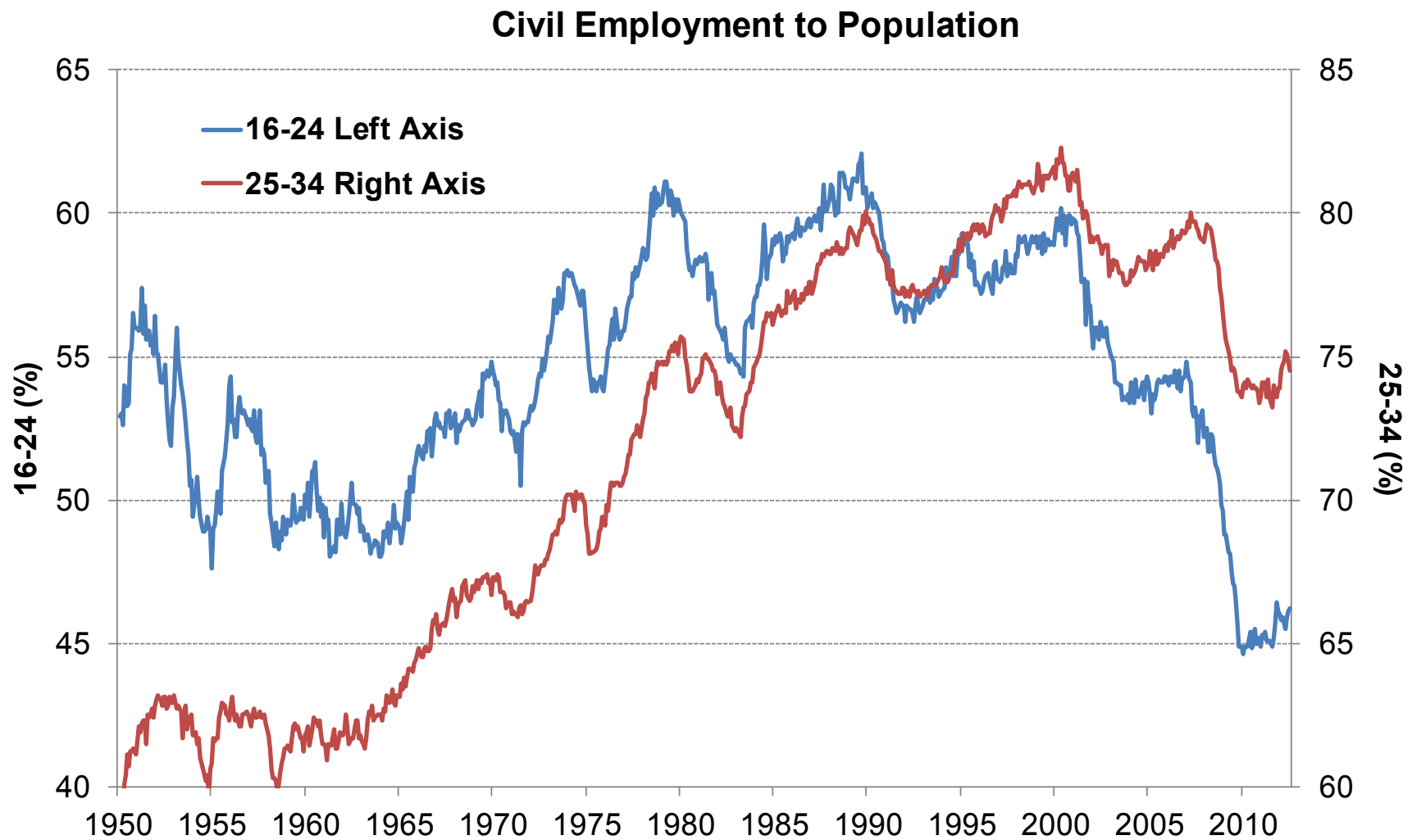




# Historically, Baby Boomer Growth Has Had a Significant Impact on Housing Demand

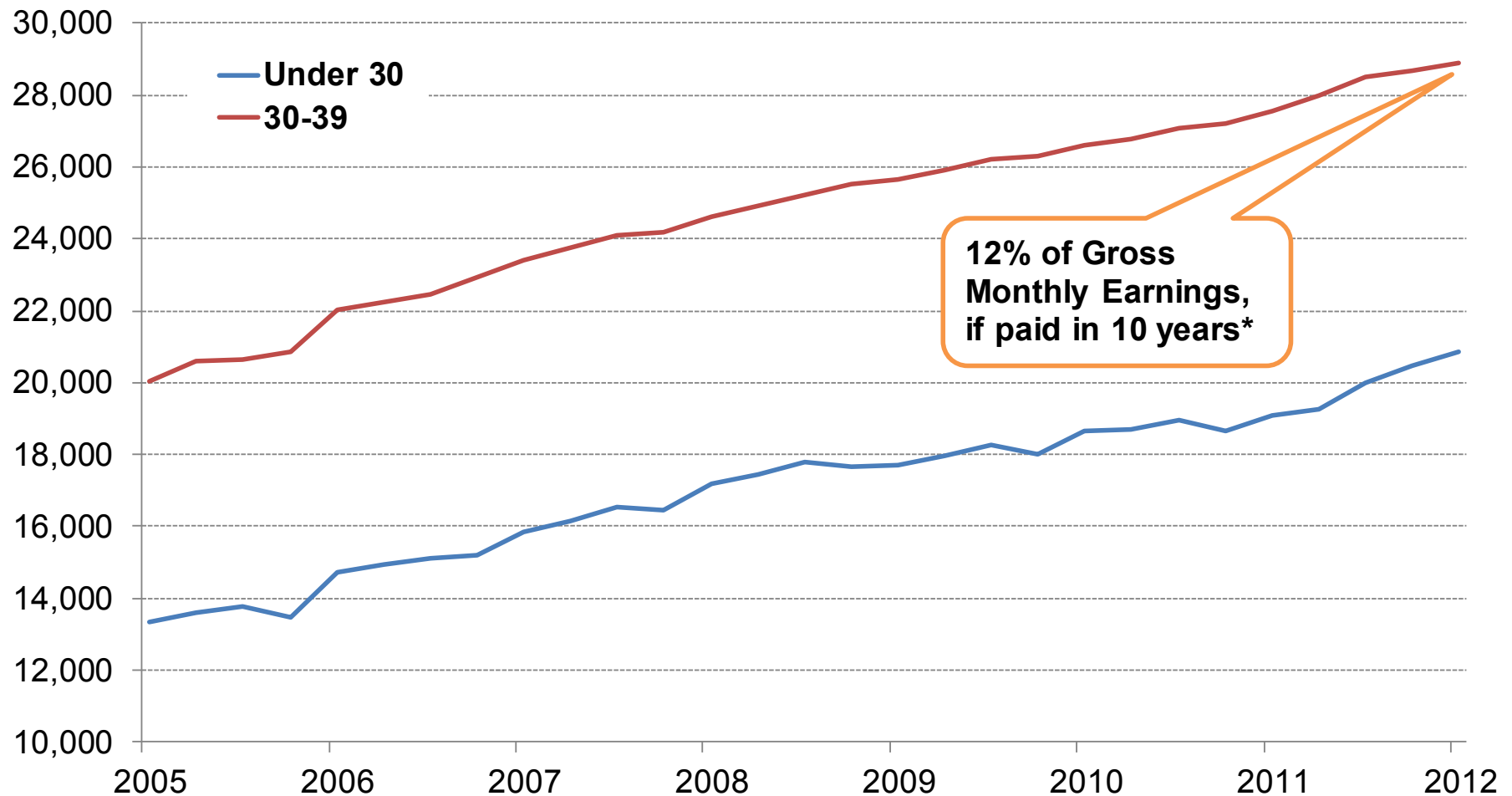


# Lower Employment Opportunities for Younger Generation



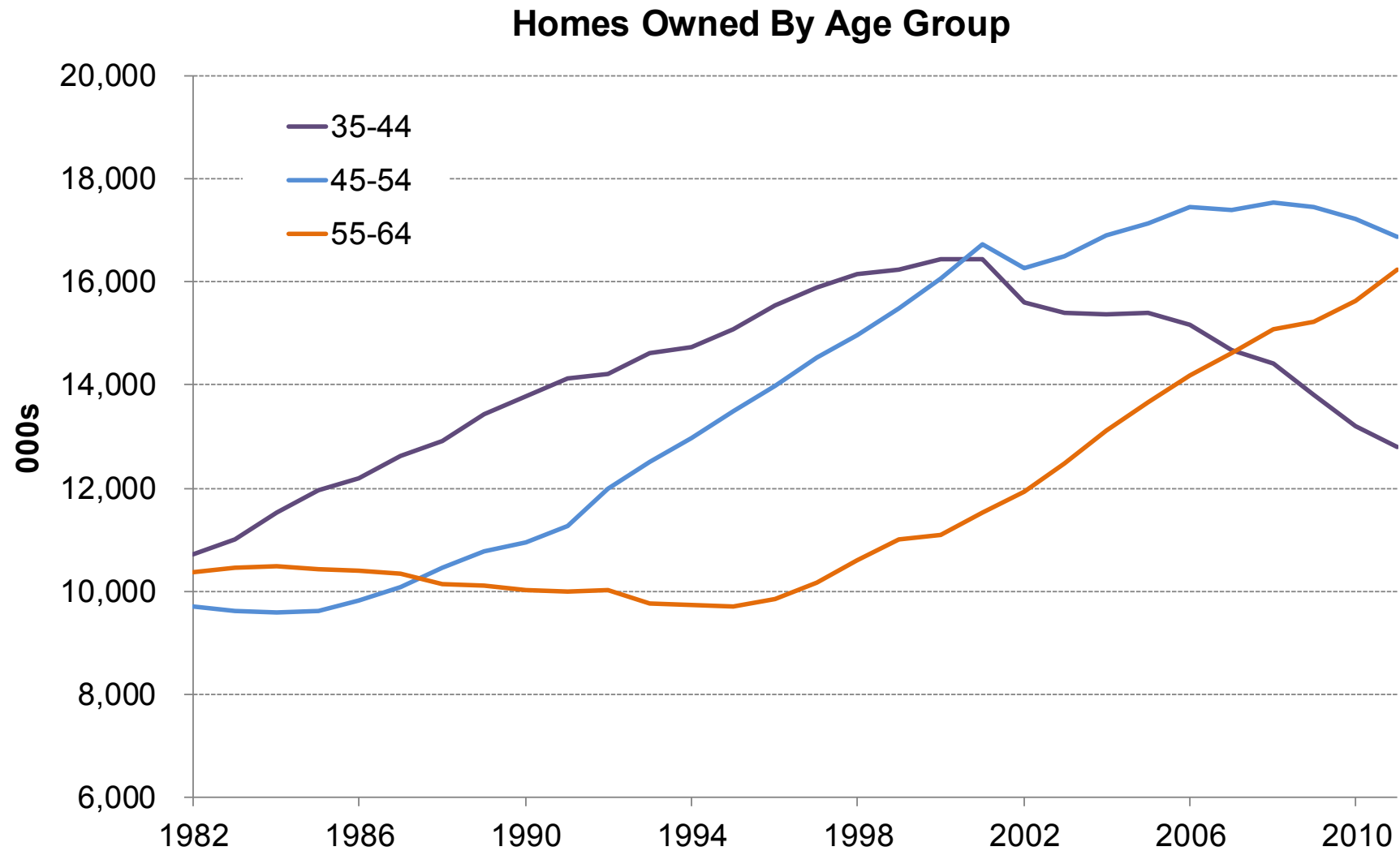
# High Indebtedness Impairs Baby Boomers' Ability to Buy Homes

## Average Student Loan Debt. Current Dollars

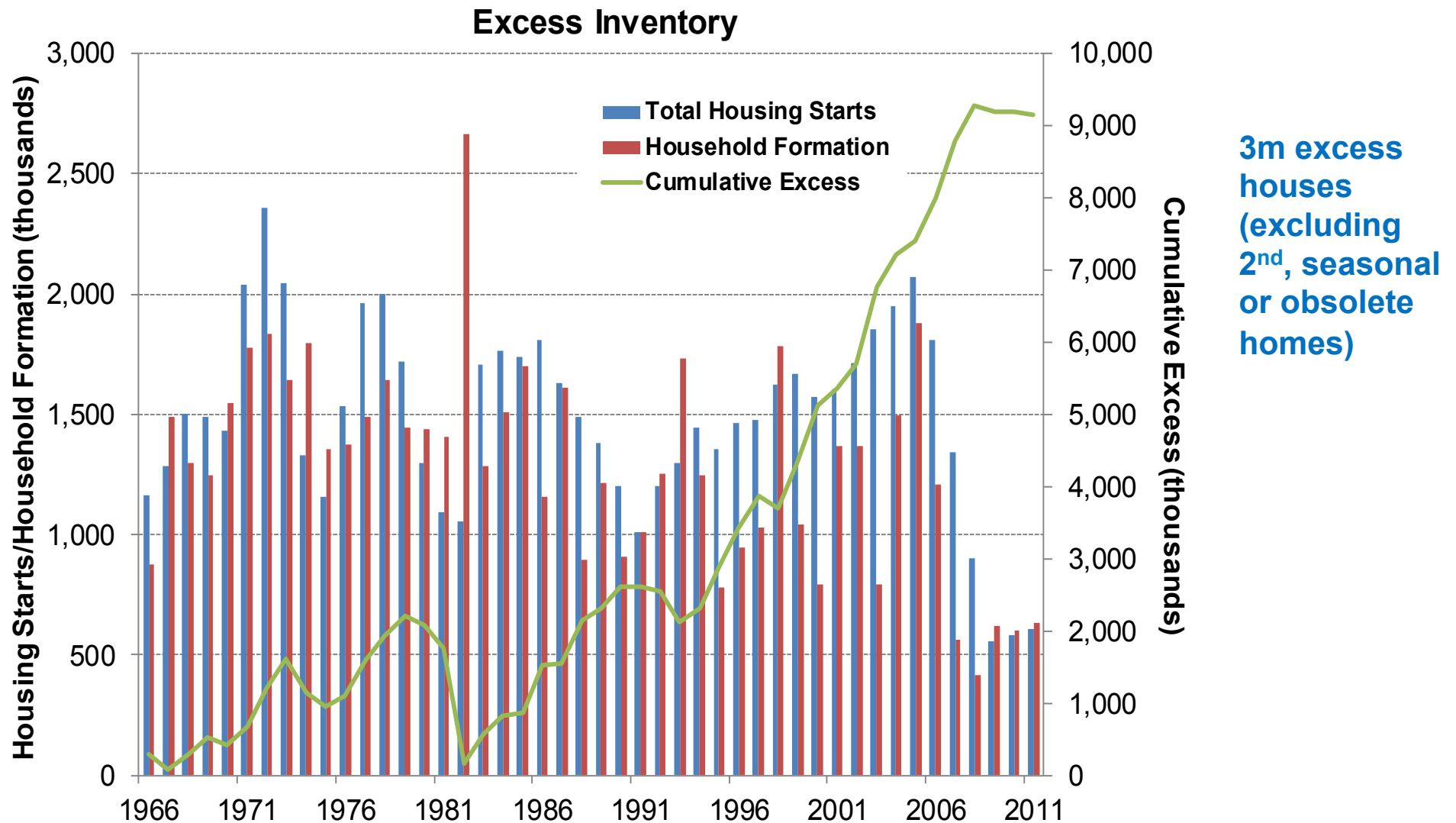


\*Gross monthly earnings: Fed Reserve of Kansas City paper: Student Loans: Overview and Issues. Monthly Gross Earnings: \$2,500.  
Other assumptions for calculations: Average debt payable in monthly installment over 10 year period. Average interest rate: 6%

# Boomer Influence on Housing is Waning



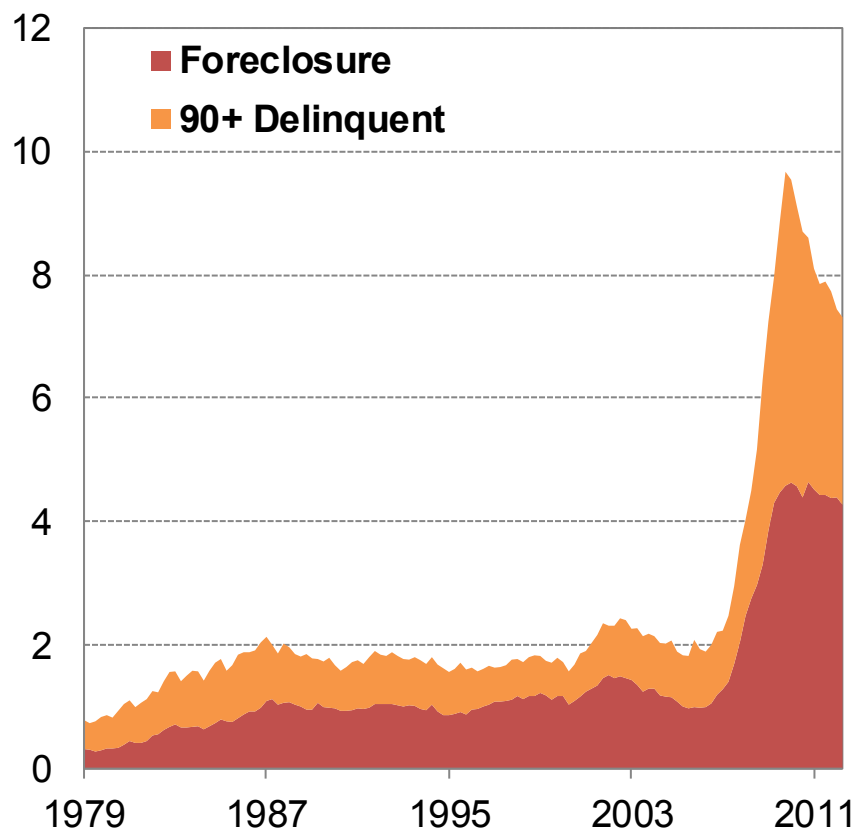
# Excess Inventory: *New Housing Starts in Excess of Formation*





# Excess Inventory: *Shadow Inventory*

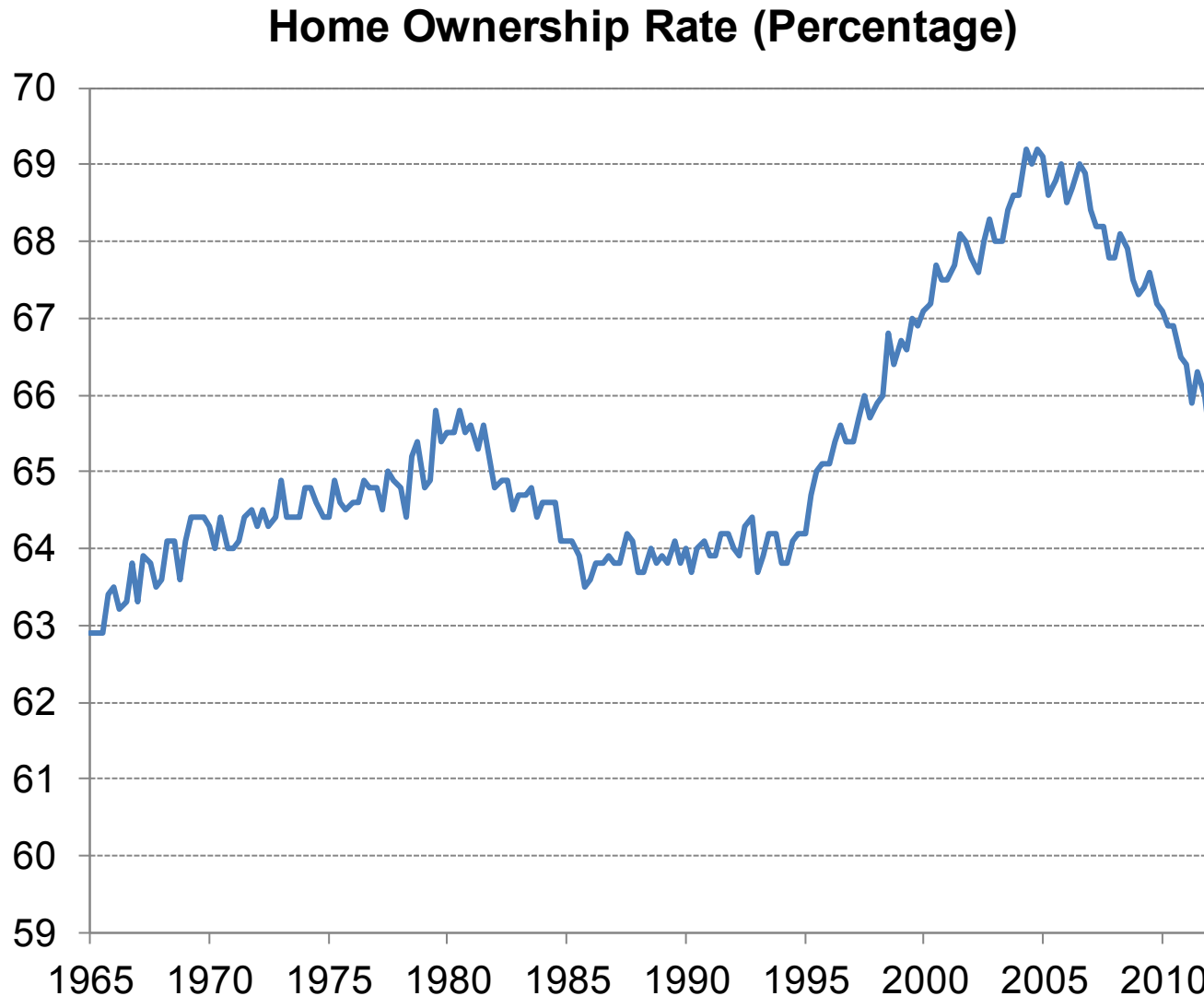
Percentage of Loans in  
Foreclosure or 90+ Days  
Delinquent



About 15m houses are high risk. 30% of these could come to market

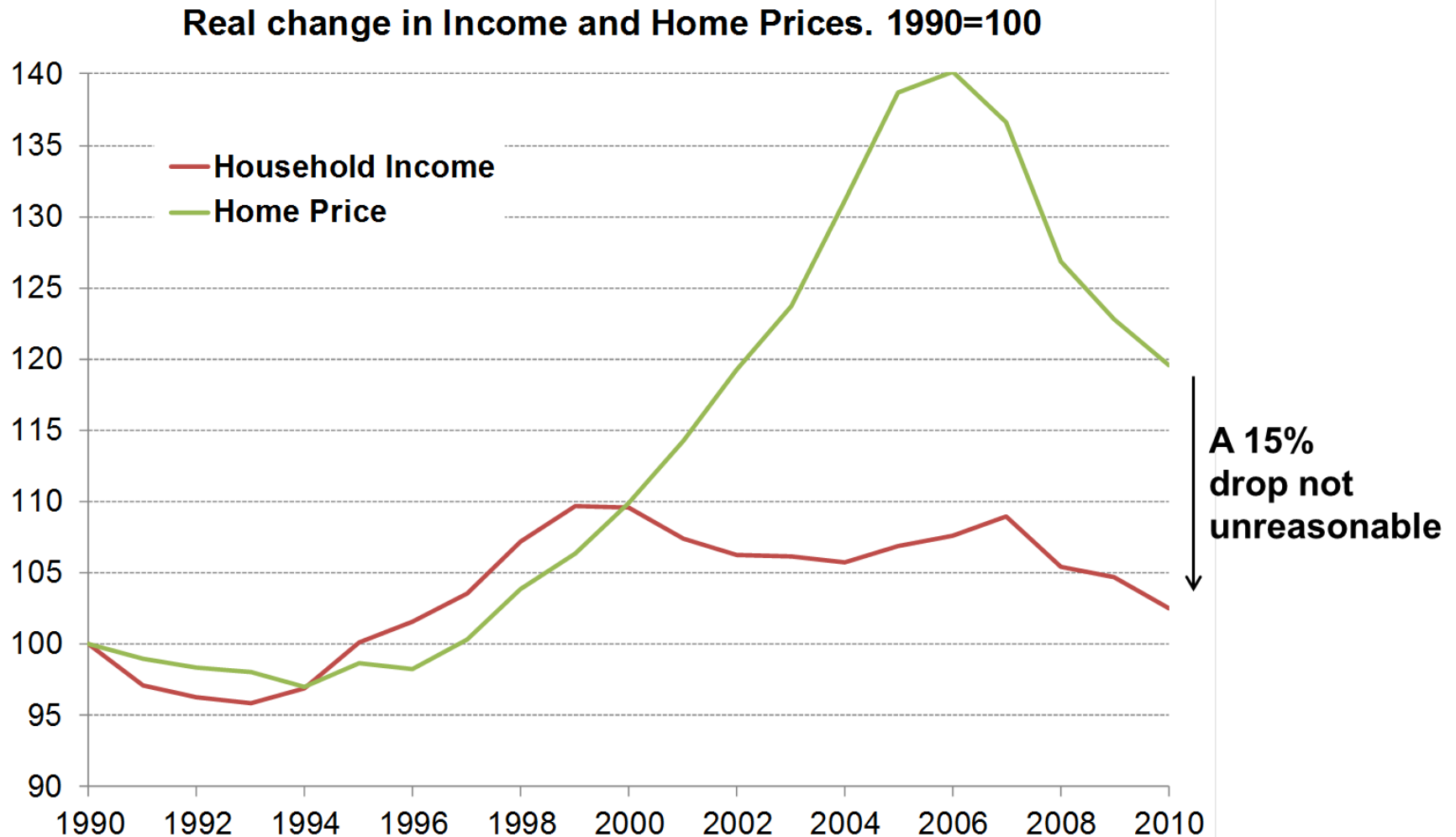
Delinquency Status	# of Loans	% of Loans	Weighted Average Mark-to-Market LTV
Non-Performing Loans	3,956,055	7.8%	116.5%
Re-Performing Loans	3,962,977	7.8%	105.3%
Always Performing Loans: MTM LTV > 120%	2,195,309	4.3%	146.7%
Always Performing Loans: MTM LTV b/w 100-120%	4,711,459	9.3%	107.0%
Always Performing Loans: MTM LTV < 100%	35,843,705	70.7%	70.1%
<b>Total</b>	<b>50,669,505</b>	<b>100.0%</b>	

# Excess Inventory: *A Normalization of Home Ownership Rate*



**Ownership  
rate declining  
to 64%  
means 2.5m  
homes at risk**

# Can Home Prices Fall any Further?



# Are There Ways to Play this Market?

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- Buy young forests with long dated maturity
- Invest in species with good supply /demand dynamics over the coming decades (Black Walnut?)
- Accept lower rates of return (3% real) on commodity softwood investments
- Wait until 2018 when many industrial supply agreements lapse and many timber funds sunset and housing market fundamentals improve.

Or, you could start now and build  
your own forest.







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40 Rowes Wharf  
Boston, Massachusetts 02110  
(617) 330-7500 | [www.gmo.com](http://www.gmo.com)