

2014 Timberland Investment Performance

U.S. private timberland investments returned 10.5 percent in 2014, reflective of positive timberland investment fundamentals and solid prospects for future growth in U.S. sawtimber demand.

As in prior years, we devote our fourth quarter issue of the *Hancock Timberland Investor* to a review of investment performance of U.S. private timberland properties.

The highest profile measure of timberland performance in the U.S. is the NCREIF (*National Council of Real Estate Investment Fiduciaries*) Timberland Property Index, which reports returns for institutional investments throughout the United States. At year-end 2014, 452 timberland properties were included in the NCREIF database. These properties contained over 13.3 million acres of timberland in the United States, with a combined market value of \$24 billion. Sixty-nine percent of the NCREIF Timberland Property Index value was located in the South, 22 percent in the West, 5 percent in the Northeast, and the remaining 4 percent in the Lake States and other regions.

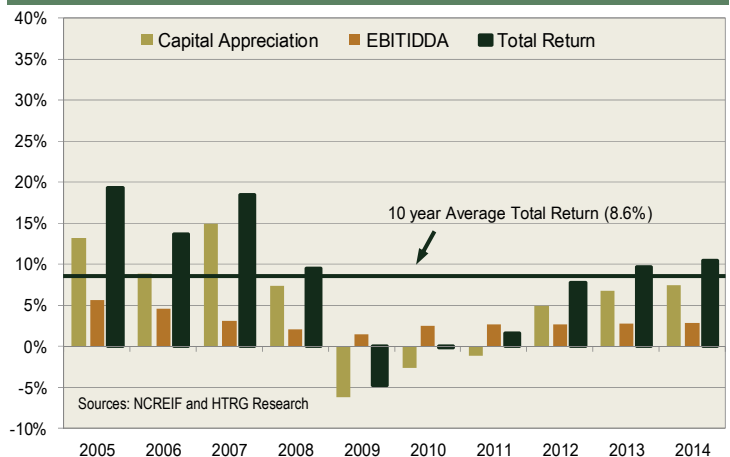
Performance Results

The Timberland Property Index total return for 2014 was 10.5 percent, an increase from 2013's 9.7 percent return and 188 basis points above the 10 year average total return of 8.6 percent. The strong performance experienced in 2014 reflected still robust log export demand from China combined with improved domestic timber demand and a favorable outlook for further gains in U.S. home construction and building product demand. In 2014, U.S. timberland investments achieved the largest calendar year total return since 2007.

NCREIF separates timberland returns into a property-level operating income or EBITDDA component and a capital appreciation component. Property-level operating income in 2014 was 2.9 percent, just above the operating income in 2013. The capital component of returns last year, at 7.5 percent, was a 70 basis point gain over 2013.

Regionally, timberland properties in the South performed better in 2014 than in 2013, while western timberland performance fell over this period. The differences in the direction of returns between the South and West were consistent across the two components of total returns, with the South experiencing gains in both operating income and capital appreciation, while western properties had reduced performance with the previous year for each return category. (See Table 1, page 2)

Chart 1: U.S. Timberland Returns (percent per year)



Southern timberland investments generated a 10.2 percent total return in 2014, a 250 bps increase from 2013's 7.7 percent total return. Income returns in the South increased 45 basis points from 2013, at 2.6 percent for 2014, the highest income return in the South since 2006. Southern timberland capital appreciation for 2014 at 7.4 percent was a 190 bps increase over 2013.

Western timberland performance at 12.0 percent in 2014 was down from the 17.4 percent return in 2013. Income returns from timberland managed in the western U.S., at 3.9 percent, was 60 bps below last year's 4.5 percent income return. Western income returns also underperformed the historical average of 4.6 percent annually over the past 10 years. The capital component of total returns for western timberland in 2014 at 7.8 percent was down 470 bps from 2013's 12.5 percent.

Differences in regional timberland performance have been pronounced in the wake of the 2008 financial crisis. For the past five years, investors in the West benefitted from strong Chinese demand for Pacific Coast log exports, which supported rising western timber prices during a time of still weak U.S. timber demand. Timberland properties in the U.S. South on the other hand, having limited access to log export opportunities and a much greater dependence on domestic markets, have contended with depressed timber prices and below average income.

(Continued on page 2)

Table 1: 2014 NCREIF Regional Timberland Returns

	South	West	Northeast	USA Wide
EBITDDA	2.6%	3.9%	2.3%	2.9%
bps change from 2013	45	-60	50	10
Capital	7.4%	7.8%	6.4%	7.5%
bps change from 2013	190	-470	900	70
Total	10.2%	12.0%	8.8%	10.5%
bps change from 2013	250	-540	970	80

Sources: NCREIF and HTRG Research

In 2014, market forces began to rebalance the growing differential between timber returns in the South and West. Slower growth in China’s overall economy and its residential construction sector in the second half of last year translated into weaker demand and timber prices in the U.S. West, which negatively impacted western income returns. Concurrently, southern timberland managers began to realize improvements in demand and pricing for sawtimber as U.S. construction activity trended higher.

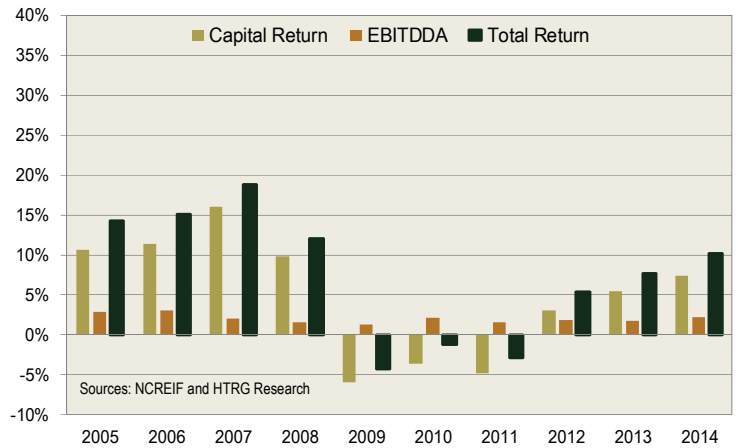
Last year’s moderation in timberland capital appreciation in the West also reflected the downward revision in prospects for continued growth in China’s appetite for U.S. logs and lumber. The improvement in the rate of capital appreciation in southern timberland last year reflected the increasingly positive signs of recovery in the U.S. economy and the housing market. Steady, sustained progress in U.S. job growth and rising consumer confidence have fostered an improved outlook for the key end-use markets (U.S. residential construction and repairs and alterations) that drive demand and prices for southern sawtimber. In addition, southern pine timber prices remain inexpensive on a global scale (See Figure 5, page 4), and the region is currently attracting significant investments in new and expanded wood product processing capacity. The anticipated positive impacts of new additions of lumber and plywood capacity were another factor contributing to the strength in capital appreciation on southern timberland in 2014.

Timberland Markets and Timberland Values

In 2014, overall timberland property values experienced solid gains as appraisers recognized a strong timberland market characterized by active transaction flow and rising transaction prices (some setting record per-acre values). Our research tracked 51 investment grade timberland transactions that closed in the U.S. last year which involved nearly 2.3 million acres.

To better monitor the historical trends in regional timberland values, we have modeled a standardized ‘fully-regulated’ forests based on NCREIF total regional returns.

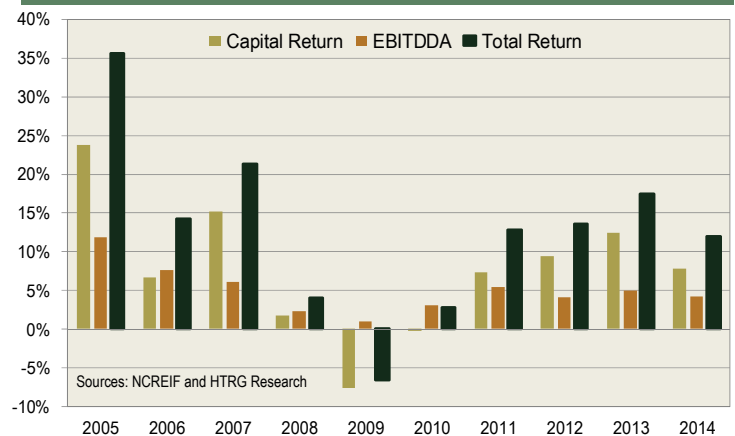
Chart 2: U.S. South Timberland Returns (percent per year)



This exercise removes the impacts of timber inventory growth and changes in the sample of properties in the NCREIF Timberland Index, providing an estimate of changes in timberland values more closely linked to shifts in market conditions. Inflation-adjusting these recalculated values allow a look at real trends in value over time (See Figure 4 on page 6)

Timberland values reached a cyclical low-point in late 2009, coinciding with the collapse in housing starts to below 500 thousand units per year, a 73 percent drop from the cyclical peak in 2006. Timberland values in both the West and South reacted to this major market dislocation, falling almost 12 percent from 2008 to 2009. The slow recovery in housing did not achieve consistent forward momentum until 2012, when housing starts reached 800 million units. (Continued on page 6)

Chart 3: U.S. West Timberland Returns (percent per year)



Quarterly U.S. Housing Starts (1,000 units) and U.S. Softwood Lumber Composite Price Index (USD per MBF)

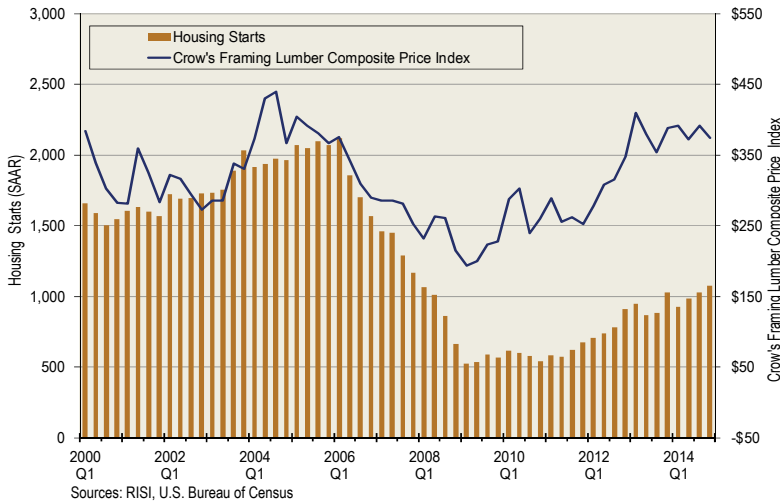


Figure 1. North American Softwood Lumber Prices and U.S. Housing Starts

In the fourth quarter, U.S. housing starts finished the year on a strong note, averaging 1.07 million units (SAAR). This boosted the total for the year to just over 1 million units, which was a moderate (8%) increase over 2013's 930,000 housing starts. The steady but slow improvement in residential construction activity was not sufficient to push softwood lumber prices higher, and the fourth quarter Crow's Framing Lumber Composite Index slipped 5% from the previous quarter and was down 4% year over year. By the end of the year, softwood lumber prices were beginning to feel downward pressure from strong gains in the U.S. dollar which were having negative impacts on offshore exports as well as encouraging increasing imports into the U.S. market.

Quarterly Australian Dwelling Unit Approvals (1,000 units) Australian Softwood Lumber Composite Price Index and Softwood Stumpage Price Index

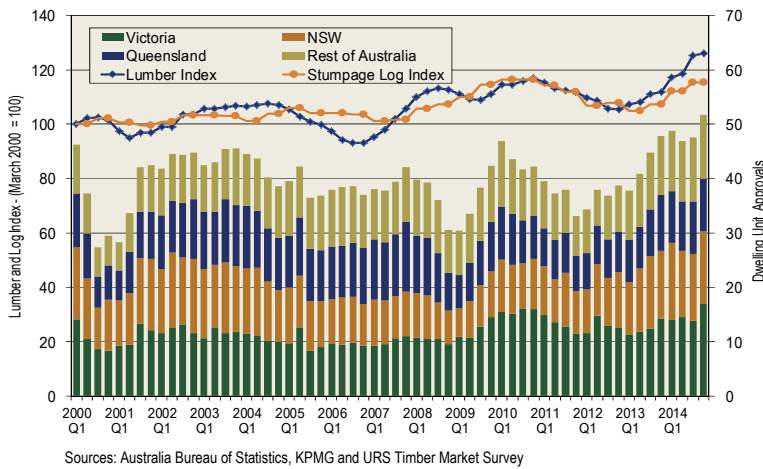


Figure 2. Australian Softwood Lumber Prices, Timber Prices, and Dwelling Unit Approvals

Dwelling approvals (a key indicator of residential construction activity) in Australia climbed higher in the fourth quarter, reaching 51,715 units, an 8% increase over the final quarter of 2013. Australian residential construction activity has benefitted from low mortgage rates and demand from Chinese buyers, but will be facing headwinds as the overall economy loses momentum. Australian structural lumber prices have moved higher in response to the increased construction activity, and in the fourth quarter, were 13% above the level a year earlier. Sawlog prices are also making gains in response to improved domestic markets and increasing volumes of log exports to China. December reporting of stumpage prices reflect a 3% gain from June.

Quarterly New Zealand Softwood Log Export Volume to China (million m3) and New Zealand Radiata Pine Log Import Price (USD/m3 cif China)

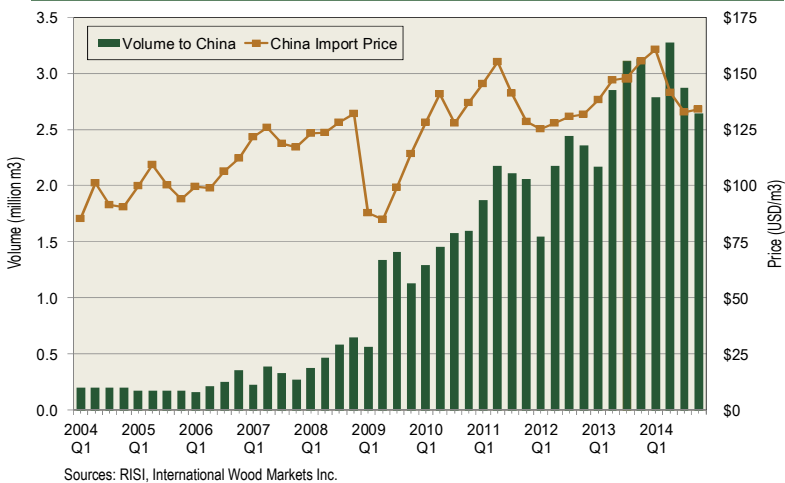


Figure 3. New Zealand Log Exports

In the fourth quarter, New Zealand sawlog exports to China continued to lose ground, and at 2.6 million cubic meters were 20% below the all-time peak reached in the second quarter. The sharp drop in New Zealand log shipments reflects a slowdown in Chinese construction activity and increased competition from other supply regions, particularly Russia. After dropping sharply in the second and third quarters in response to weaker demand in China, the price of New Zealand sawlogs in China stabilized in the final quarter of 2014 at \$134 per cubic meter, down 17% from the high-point of \$161 per cubic meter set in the first quarter of this year.

Monthly Exchange Rates Between USD and Commodity Currencies

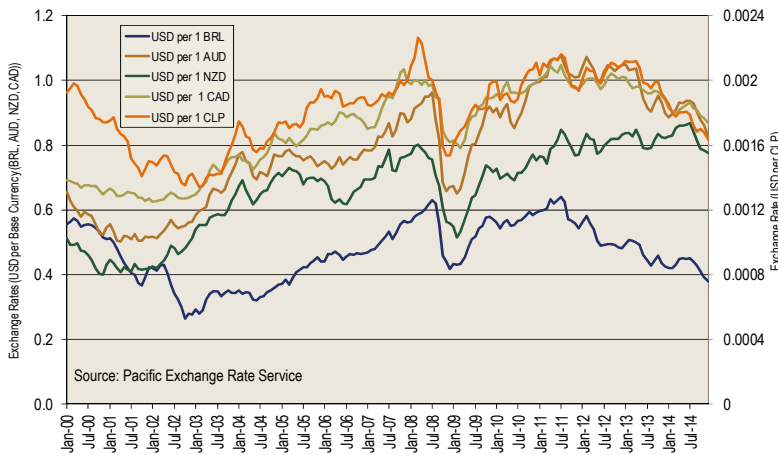


Figure 4. Exchange Rates

The U.S. dollar continued to register gains against the currencies of Australia, Brazil, Canada, Chile and New Zealand. The U.S. dollar was supported by growth in its domestic economy, anticipation of the U.S. Federal Reserve moving to a tighter monetary policy, and international funds moving to the U.S. currency as a safe haven in response to the ongoing political unrest in the Mid East and Ukraine. The Brazilian real lost the most ground against the U.S. dollar in the final quarter of the year, dropping 13%, reflecting deteriorating commodity prices for agricultural and mineral exports and a domestic economy edging toward recession.

Quarterly Average Regional Composite Prices for Softwood Sawtimber Stumpage (USD per m3)

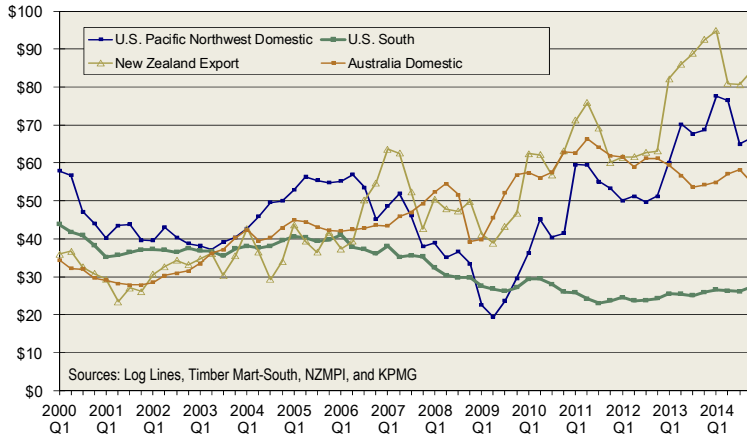


Figure 5. Regional Softwood Sawtimber Stumpage Prices

With sawlog inventories in China trending lower, prices for sawlogs in the Pacific Rim stabilized and made incremental gains in the fourth quarter. New Zealand export sawlog prices were up 4% in the fourth quarter, while log prices in the U.S. Pacific Northwest recovered a modest 2%. Australian timber prices, expressed in USD, fell 6% fourth quarter - reflective of the strong USD against the AUD. Timber prices in the U.S. South continued to make measured gains, and in the fourth quarter southern pine timber prices were up nearly 6% year-over-year. Sawtimber prices in the U.S. South at the end of 2014 were the highest in four years, but still remained one third below the price peaks reached in 2005 and 2006.

Quarterly Prices for Market Pulp and Fiber (USD per metric ton)

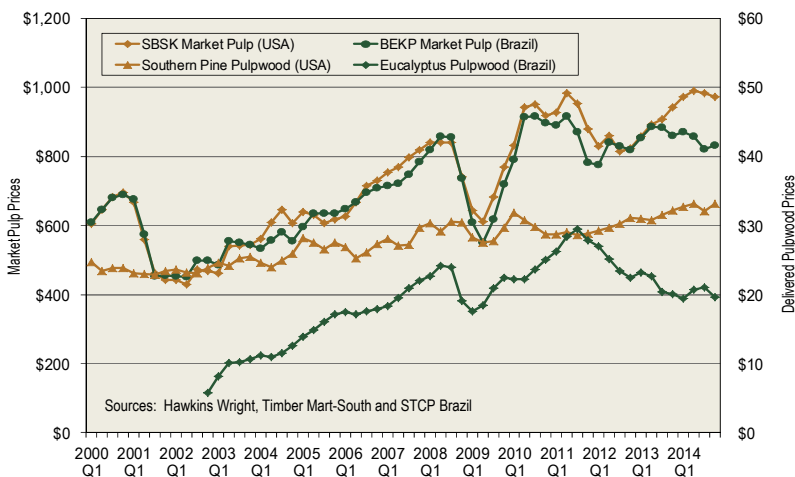


Figure 6. Pulp and Pulpwood Prices, U.S. South and Brazil

In the fourth quarter, Bleached Eucalyptus Kraft Pulp (BEKP) made a modest gain of 1% from the previous quarter, and at US\$ 832, BEKP was down 3% from the final quarter of last year. Although BEKP prices have stabilized, more new capacity is still in the pipeline and demand growth will be vulnerable to the on-going economic weakness in Europe and China. Southern Bleached Softwood Kraft (SBSK) prices eased a bit at the second half of last year, but in the fourth quarter were only 2% below the cyclical peak of \$990 reached in the second quarter. Pine pulpwood delivered prices in the U.S. South have been relatively stable over the past year, reflecting balanced market conditions. In the fourth quarter, Brazilian eucalyptus pulpwood prices slipped 6% in USD, but in local currency terms achieved a modest gain.

U.S. Timberland Annualized Operating Cash Yields (percent per year)

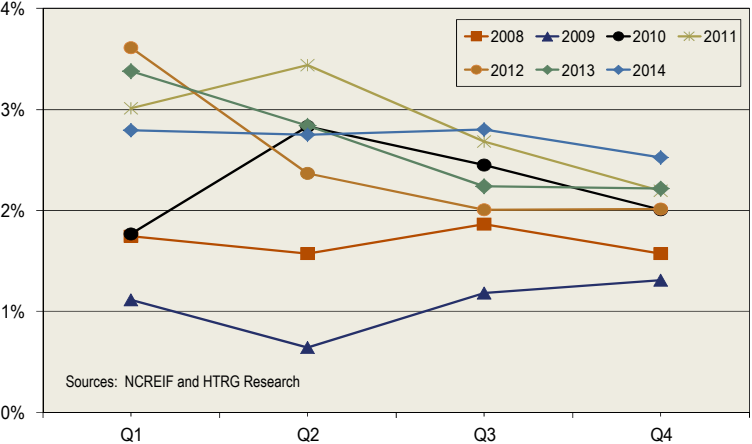


Figure 7. U.S. Timberland Operating Cash Yields
Annualized cash yields from U.S. timberland properties as reported by NCREIF were 2.5% in the fourth quarter, which was the strongest fourth quarter performance for timberland returns in the past eight years. Timberland cash yields are reflecting the increased demand and renewed profitability in the U.S. solid wood products sector. Regionally, cash yields from timberland in the U.S. West trended lower over the course of 2014, and in the fourth quarter were down 0.5% from the first quarter, while cash yields from operating timberland in the U.S. South were up, increasing 0.2% between the first and last quarter.

Monthly Securitized Timberland Share Value (Indexed to 100 at start date)

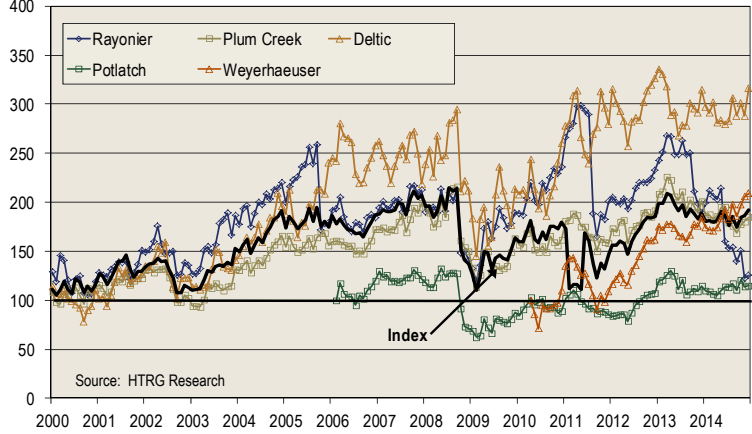


Figure 8. Hancock Securitized Timberland Index
The Hancock Securitized Timberland Index, a market-capitalized weighted public market performance Index, rose 5% in the fourth quarter, gaining back most of last quarter's losses. Income gains from timber revenue during the fourth quarter drove performance. All companies within the Index, except for Rayonier, contributed to the fourth quarter rise: Plum Creek gaining 4%; Potlatch and Deltic 3%; and Weyerhaeuser 8%. Rayonier's disclosure in the fourth quarter of deficits in internal forest resource controls leading to timber inventory and harvest planning restatements slashed its share value 19% from October to November. The company's quick replacement of management and transparency offered in its November and December reporting have helped turn around its share price slide, increasing 2% from November to December.

Quarterly U.S. South Timberland Values (\$ per acre)

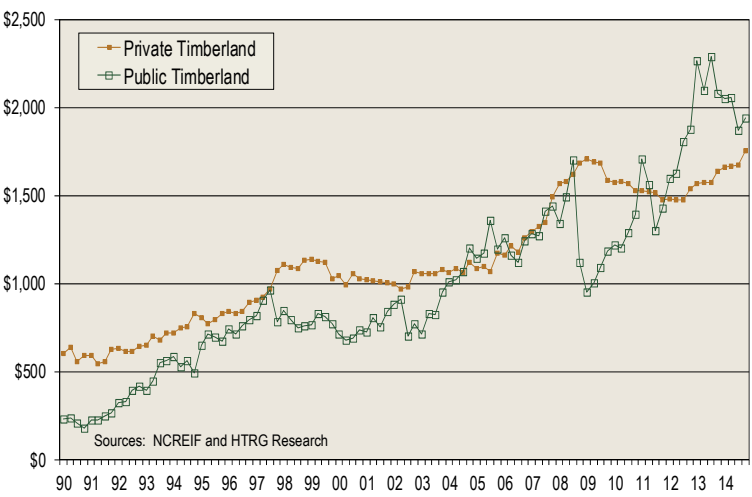
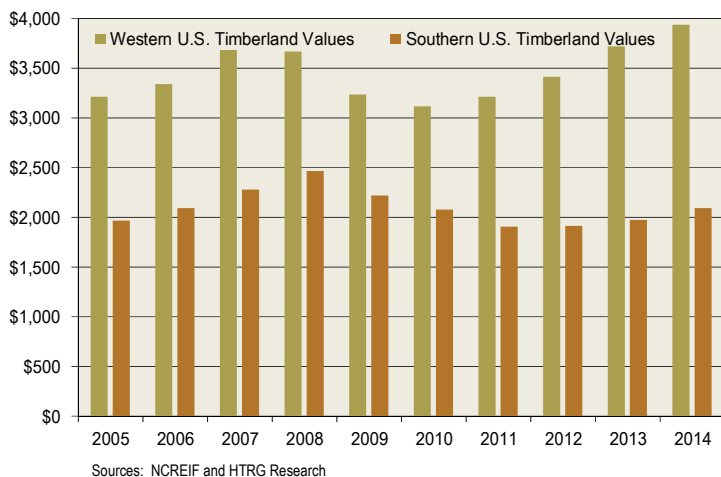



Figure 9. Timberland Enterprise Value
In the third quarter, estimates of Southern U.S. timberland per-acre values for publicly traded REITs compared to privately held institutional timberlands continued to converge, narrowing the value spread between public and private timberland assets to \$183 per acre. The Timberland Enterprise Value per Southern Equivalent Acre (TEV/SEA) – a measure of Southern timberland value for public timber-REITs – has fallen \$143 per acre over the past four quarters. In contrast, timberland held by private institutional investors – measured by the NCREIF Timberland Property Index in the U.S. South – rose \$117 per acre over the same time period.

Chart 4: U.S. Timberland Values for a Prototypical All Age Property (2014 \$ per acre)



In 2013, southern timberland values turned a corner, increasing 3.0 percent, while western timberland values continued to gain momentum, rising 9.0 percent from 2012 to 2013.

By the second half of 2014, residential construction was positioned for continued growth based on solid fundamentals: access to credit for home buyers is easing; the labor market is quickly approaching full employment; and wages are poised to rise. Timberland investors and appraisers have incorporated this increasingly optimistic outlook into their calculations of U.S. timberland values. Our estimates of real timberland values based on our “fully-regulated forest” model indicate that southern timberland values rose 6.1 percent in 2014, and western timberland values appreciated 5.8 percent. The rate of appreciation in western timberland values moderated in 2014, and was approximately one third the rate of increase achieved in 2013. Still, 2014 timberland values in the West have reached a ten year peak, surpassing the prior peak set in 2008 by 7.0 percent 

By 2012, southern timberland values had fallen 22 percent from their 2008 peak, and reached a bottom. In the West, with the option to diversify harvest demand away from construction markets in the U.S. to those in China, timberland values appreciated 5.4 percent from 2009 to 2012.

¹ See HTI 2Q 2002 for a full description of our methodology

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NOTES:

Figure 1. The source for the U.S. Housing Starts is U.S. Bureau of Census. The Housing Starts data includes Single-family and Multi-family starts. Crows Framing Lumber Composite Index data is RISI.

Figure 2. Quarterly Australian Dwelling Unit Approvals is published by the Australian Bureau of Statistics. The Lumber Index is published by URS Timber Market Survey using Softwood Structural lumber prices (Blended Price - 60 percent MGP 10 90x35x4800, 40 percent MGP 10 70x35x4800). Log Price Index is calculated using the (APLPI) Radiata Pine Domestic Stumpage prices. The log price is an average of Intermediate and Medium sawlog prices

Figure 3. Quarterly New Zealand softwood log export volume to China and China Import prices are published by the RISI International Timber Service.

Figure 4. Monthly average Exchange Rates are published by the Pacific Exchange Rate Service.

Figure 5. Quarterly Softwood Sawtimber Stumpage Prices for the U.S. Pacific Northwest is reported in Loglines published by RISI. The weighted index is made up of 50 percent Domestic Douglas-fir (47 percent #2 and 53 percent #3 Sawmill sorts) and 50 percent Whitewoods (47 percent #2 and 53 percent #3 Sawmill sorts). U.S. South prices are published by Timber Mart-South (60 percent Southern Pine Sawtimber and 40 percent Chip-n-Saw). Australian domestic prices are calculated using the KPMG Australian Pine Log Price Index (APLPI) Radiata Pine Domestic Stumpage prices. The log price is an average of Intermediate and Medium sawlog prices converted to USD/m3. New Zealand radiata pine export log prices are a blend of A,K and J sort logs published by New Zealand Ministry of Primary Industries converted to USD.

Figure 6. Quarterly Market Pulp prices are published by Hawkins Wright. U.S. Southern Pine Pulpwood prices are published by Timber Mart-South. Brazil Eucalyptus Pulpwood prices are published by STCP Engenharia de Projetos Ltda.

Figure 7. Annualized Operating Cash Yields are published by National Council of Real Estate Investment Fiduciaries (NCREIF). Yields are calculated using 60 percent U.S. South and 40 percent U.S. West.

Figure 8. The Hancock Securitized Timberland Index (HSTI) uses a base-weighted aggregate methodology (similar to that used to construct the S&P 500) to calculate a market capitalization-weighted value for five publicly traded timber-intensive forest products companies. Base weights were adjusted for the emergence of new companies or at the beginning of each year. Dividends are not reinvested. The companies included in the HSTI have no investment relationship with Hancock Timber Resource Group.

Figure 9. Public equity values are derived from our Timberland Enterprise Value per Southern Equivalent Acre (TEV/SEA) calculation for five timber-intensive publicly traded companies as compared to southern timberland values per acre calculated from the NCREIF database. TEV is a quarterly estimate based on total enterprise value (total market equity + book value debt) less estimated value of processing facilities, other non-timber assets and non-enterprise working capital. SEA uses regional NCREIF \$/acre values to translate a company's timberland holdings in various regions to the area of southern timberland that would have an equivalent market value.

References to expected investment performance in this newsletter are based on historical information and are based on managements projections. Potential for profit as well as for loss exists.