

2013 Timberland Performance

At 2013 year end, the NCREIF Timberland Property Index posted a total annual return of 9.7 percent. Stronger timber demand in the U.S. and China supported modest growth in timber income, while capital appreciation on timberland properties benefitted from upward adjustments in property appraisals. The principal driver of the stronger timberland returns achieved in 2013 was reductions in the discount rates used by appraisers in their property valuations, based on higher levels of confidence in the prospects for both wood products and timberland markets.

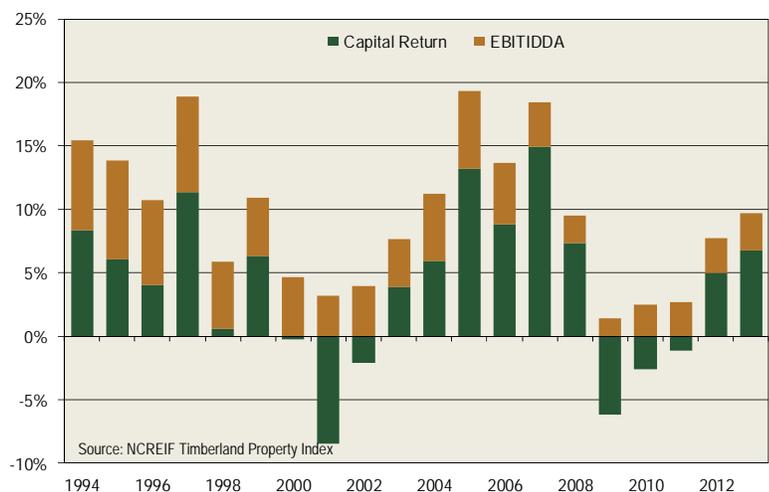
With 2013 behind us, we again devote our fourth quarter issue of the *Hancock Timberland Investor* to a review of the past year's timberland investment performance. Our measure of timberland performance is the NCREIF Timberland Property Index¹ which reports returns for institutional investments in timberland properties throughout the United States.

NCREIF timberland properties numbered 457 as of fourth quarter 2013. These properties contained over 13.6 million acres within the United States, with a combined market value of \$23.1 billion. Seventy-one percent of the Index value was in the South, 24 percent in the Northwest and the remaining 5 percent in the Northeast, Lake States, and 'Other' regions. Properties in the Northwest had the greatest per-acre market value, with a fourth quarter average of \$2,367. Southern timberland properties averaged \$1,637 per acre. Timberlands in the Northeast were valued at \$1,390 per acre on average, and timberlands in the Lake States at \$686 per acre.

2013 Performance Results

The total return for the Timberland Property Index for calendar year 2013 – a positive 9.7 percent – moved closer to historical averages (Chart 1). NCREIF separates timberland returns into a property-level operating income or EBITDDA component and a capital appreciation or depreciation component. The calendar year EBITDDA return was a positive 2.8 percent, a value similar to the past three years. The cash yield from operations after deductions for capital expenditures was 2.4 percent in 2013 – also similar to the past three years. NCREIF capital returns were a positive 6.8 percent, marking the fourth consecutive year of improved capital appreciation.

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



Regionally, timberland in the Northwest produced the highest returns in 2013, 17.4 percent, which was 390 bps higher than in 2012, and the third year in a row of double-digit returns in the region. Total returns for properties in the South, at 7.7 percent, were a 232 bps increase over the previous year. Properties in the Northeast posted a negative 0.9 percent return for 2013 and properties in the Lake States, 12.61 percent (see Table 1, page 2).

Timberland property operating income (EBITDDA) returns were also highest in the Northwest at 4.5 percent. The combination of rising production at the region's saw mills and plywood plants in combination with strong export log demand to China provided broad based market support for timber prices.

In the South, 2013 operating income benefited from higher production at the region's wood product mills, but

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Table 1: 2013 NCREIF Regional Timberland Returns in the U.S.

	South	Northwest	Northeast	Lake States	USA Wide
EBITDDA	2.2%	4.5%	1.8%	1.2%	2.8%
bps change from 2012	-12	67	7	89	11
Capital	5.5%	12.5%	-2.6%	11.3%	6.8%
bps change from 2012	242	304	-535	729	178
Total	7.7%	17.4%	-0.9%	12.6%	9.7%
bps change from 2012	232	390	-534	828	193

Source: NCREIF Timberland Property Index

lacking exposure to Asian log markets, southern timber prices made only modest gains. Consequently, 2013 EBITDDA returns in the South were just 2.2 percent. The still low timber prices in the South for both sawtimber and pulpwood have enhanced the competitive position of the region’s forest product sector in global markets, triggering a wave of new investment in lumber and wood pellet capacity. This expansion of the South’s forest product production base is expected to have a positive impact on the region’s future operating income returns.

A Closer look at NCREIF Northwest Timberland Values and Appreciation

Significant changes in the composition of the properties reporting into the NCREIF Timberland Index have occurred over the past two years in the Northwest. These changes have impacted per acre values calculated from the Northwest NCREIF data.

In Q4 2012, the appraisal frequency requirement for timberlands included in the NCREIF Timberland Index tightened, moving from a once-every-three year external appraisal requirement to an annual external appraisal requirement. GIPS (Global Investment Performance Standards) mandates this higher external appraisal frequency for compliance. Commercial real estate firms contributing to NCREIF’s Commercial Property Index (NPI) were moving to conform to these GIPS standards, and NCREIF’s timberland contributors took the necessary steps to comply with this GIPS standard. After imposing the annual external appraisal requirement, 30 timberland properties dropped out of the NCREIF Index in Q4 2012. The bulk of these properties were in the Northwest region.

Also in Q4 2012, Hancock Timber Resource Group (HTRG) completed a large acquisition, and added these properties to the NCREIF database. A number of these

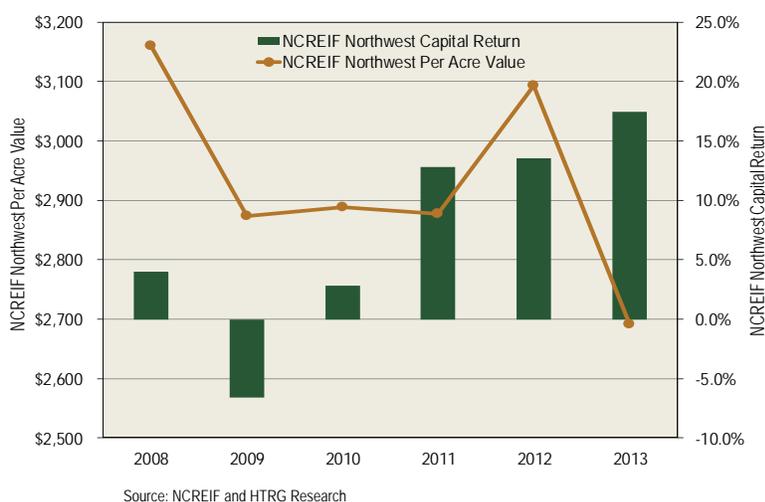
properties straddled the NCREIF regions of Pacific Northwest (Oregon, Washington, and California) and a catch all category ‘Other’, which included the state of Idaho. The Timberland Committee voted to rename the Pacific Northwest region Northwest and widen its geographic scope to include Idaho. The following quarter, any additional Idaho timberland properties in the NCREIF database were also included in the renamed Northwest region.

And then, in Q3 2013, a large, West Coast property managed by Brookfield Timberlands Management, a NCREIF Timberland Index contributing member, was sold to Weyerhaeuser, a non-contributing member, and removed from the Northwest Index, again significantly impacting the sample of properties in the Northwest region. Additionally during the quarter, HTRG sold 95,000 acres in Washington state to a non-contributing member and these acres were also taken out of the NCREIF database. NCREIF’s total Northwest regional market value dropped 33 percent from Q2 2013 to Q3 2013.

Isolating the exact effects of these multiple changes to the Northwest Index is difficult as NCREIF imposes strict masking requirements, protecting the confidentiality of contributing members’ individual performance. Nonetheless, recent declines in per acre values calculated from the NCREIF Northwest database have not corresponded with the positive movements in property

(Continued on page 6)

Chart 2: NCREIF Northwest Timberland Value per Acre and Capital Return



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

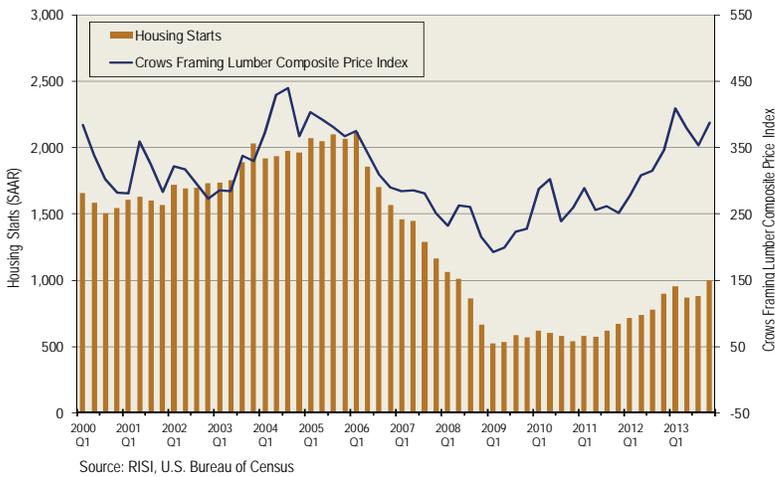


Figure 1. North American Softwood Lumber Prices and U.S. Housing Starts

North American softwood lumber prices moved forward in the final quarter of 2013, pushing the Crows Framing Lumber Composite Index up 10 percent compared to the previous quarter, and 12 percent higher than the fourth quarter of last year. Lumber prices were supported by holiday down-time and increased builder confidence about the prospects for 2014. U.S. residential construction activity regained forward momentum in the fourth quarter, with U.S. housing starts averaging 1,002,000 units (SAAR), up 13 percent from 882,000 units in the previous quarter. The advances in U.S. housing at the end of the year occurred despite bouts of extreme cold weather and higher mortgage rates, indicating improved underlying demand.

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

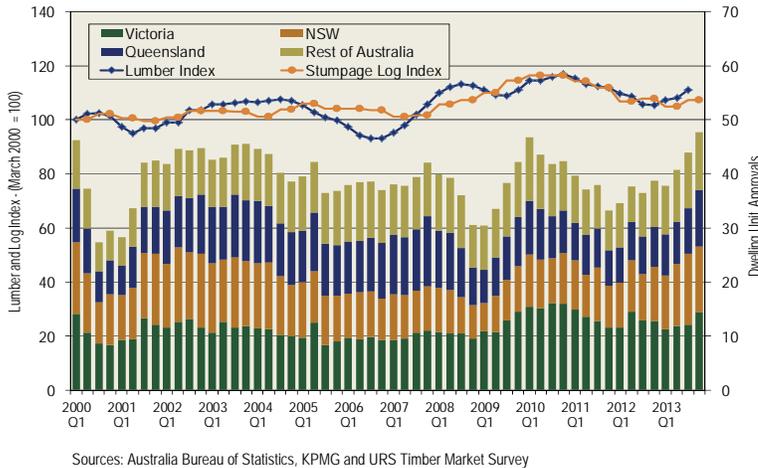


Figure 2. Australian Softwood Lumber, Timber Prices, Dwelling Unit Approvals

Dwelling construction approvals made solid progress in the fourth quarter of 2013, increasing 8 percent over the previous quarter. At 47,724 units, Australian construction approvals in the fourth quarter hit a decade high. Activity increased across Australia, with particular strength in New South Wales and the Sydney market. The improving pace in Australian residential construction was supported by low interest rates and increased demand from Chinese investors. The improved construction activity is expected to translate into modest increases in Australian softwood lumber prices. Following the third quarter's 3.0 percent rise in lumber prices, the recent stronger construction approvals are expected to push lumber prices higher. Log prices also showed gains, in the second half of 2013, registering a 2.3 percent increase over the first half of the year.

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's export volume of pine sawlogs to China continued at the record pace of the third quarter. The total volume of New Zealand's log exports to China in 2013 was 32 percent above 2012. In the final quarter of 2013, the China import price for New Zealand radiata pine sawlogs increased to US \$159 per cubic meter delivered in China, up 5 percent from the previous quarter. Reflecting the improved sawlog demand in China compared to the weaker markets in 2012, New Zealand radiata pine sawlog prices delivered into China for 2013 were on average 14 percent above the average for 2012.

Monthly exchange rates between USD and Commodity Currencies

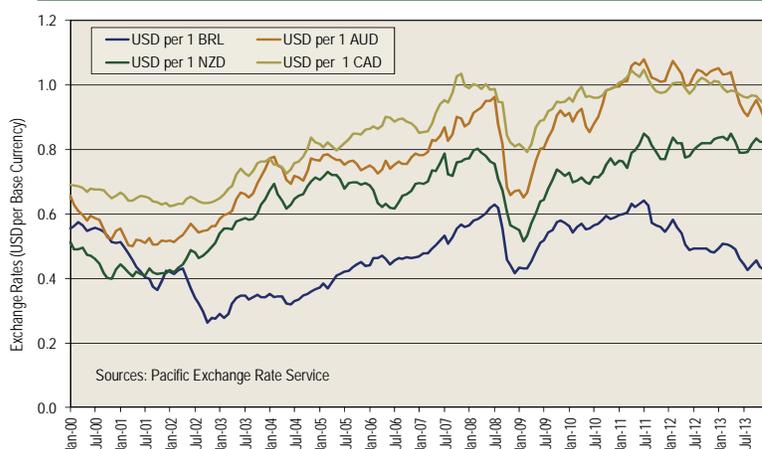


Figure 4. Exchange Rates

The currencies of Australia, Brazil and Canada took another downward step relative to the U.S. dollar (USD) in the fourth quarter. By the end of the year, the U.S. economy was showing modest improvements, allowing the Federal Reserve to begin reducing their bond purchase program. With the prospect of international fund flows shifting away from developing markets back to the U.S., the USD has gained ground against numerous currencies. In December, the Australian dollar was down 14 percent from the same month a year ago; the Brazil real was down 11 percent and the Canadian dollar was 7 percent lower. New Zealand's currency has largely held its ground against the dollar, and in December was down only 1 percent compared to the same month a year ago, supported by robust exports to China and strong domestic economic activity.

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

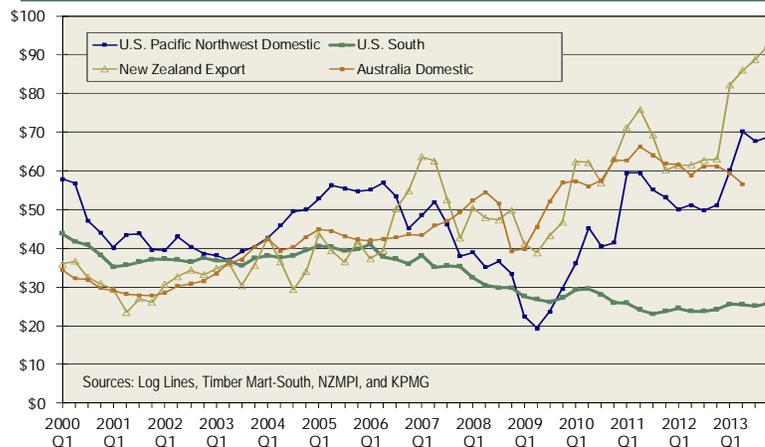


Figure 5. Regional Softwood Sawtimber Stumpage Prices

At the end of 2013, softwood stumpage prices were positive across a broad range of markets, with those having exposure to strong Chinese demand showing the most strength. In the fourth quarter, New Zealand softwood sawtimber stumpage prices increased 4 percent to US\$93 per cubic meter, up 42 percent from a year ago. Stumpage prices in the U.S. Pacific Northwest edged higher in the fourth quarter, supported by rising domestic lumber prices and strong log exports, and were 34 percent higher than the final quarter in 2012. In the U.S. South, pine sawtimber stumpage prices improved modestly, up just 3 percent, in the fourth quarter, responding to recovering lumber production. With limited Asian export opportunities, southern pine stumpage prices were just 7 percent above the fourth quarter of last year.

Quarterly Prices for market pulp and fiber (USD per metric ton)

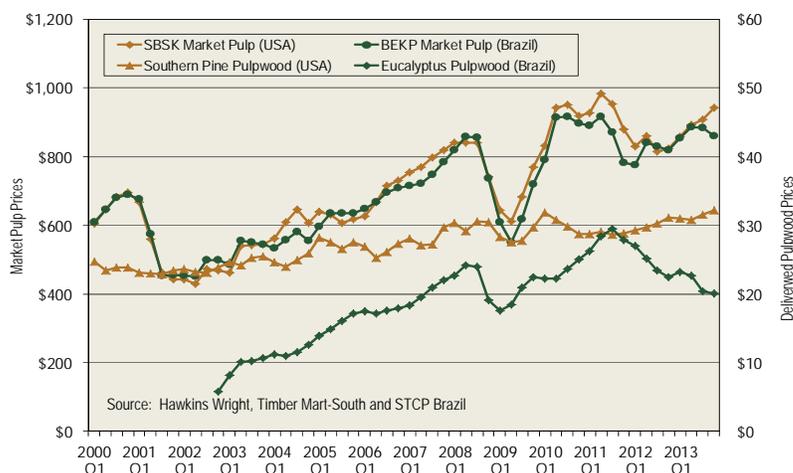


Figure 6. Pulp and Pulpwood Prices, U.S. South and Brazil

The prices for softwood and hardwood market pulp continued to move in opposite directions in the fourth quarter. U.S. southern bleached softwood kraft (SBSK) prices gained 4 percent, moving to \$942 per tonne, while Brazilian eucalyptus kraft pulp (BEKP) prices lost 3 percent, slipping to \$860 per tonne. Reflecting the movements in their respective pulp markets, Southern Pine pulpwood prices made a modest gain of 2 percent in the fourth quarter, while Brazilian Eucalyptus fell 2 percent from the previous quarter. Southern pulpwood prices found added support in increased demand from the region's recovering OSB mills.

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

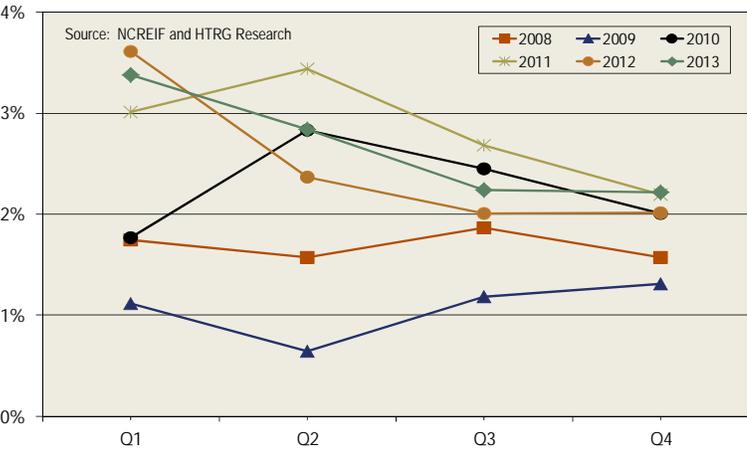


Figure 7. U.S. Timberland Annualized Operating Cash Yields (percent per year)

The fourth quarter annualized cash yield for privately held U.S. timberland, as reported by NCREIF, was flat from last quarter levels at 2.2 percent, yet equal to fourth quarter 2011 – the highest yield reported over the past five years. In the South, annualized cash yields fell 25 bps from last quarter, while yields in the Northwest rose 33 bps.

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

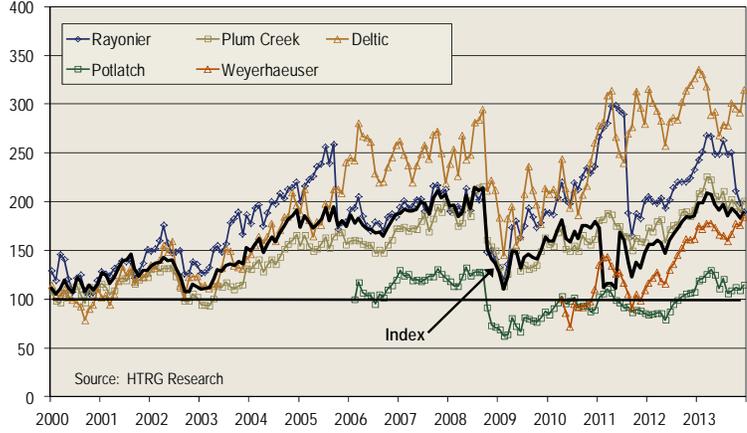


Figure 8. Hancock Securitized Timberland Index

The Hancock Securitized Timberland Index ended the fourth quarter down -1.4 percent due solely to the large swing in Rayonier’s share price. In October, shares of Rayonier fell 15 percent after earnings targets were missed for the third quarter, and management proffered that possible oversupply in specialty fibers markets may pull down future pricing. Rayonier contributes just under 20 percent to the market capitalized HSTI Index. Rayonier’s announcement in December calling for plans to separate its Performance Fibers segment from its Timberland/Real Estate business in mid-2014, did little to move its share price up or down. All other contributors to the Index – Plum Creek, Weyerhaeuser, Potlatch, and Deltic – posted share price gains during fourth quarter on expectations for continued demand improvement in the U.S. wood products markets and exports to Asian market.

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

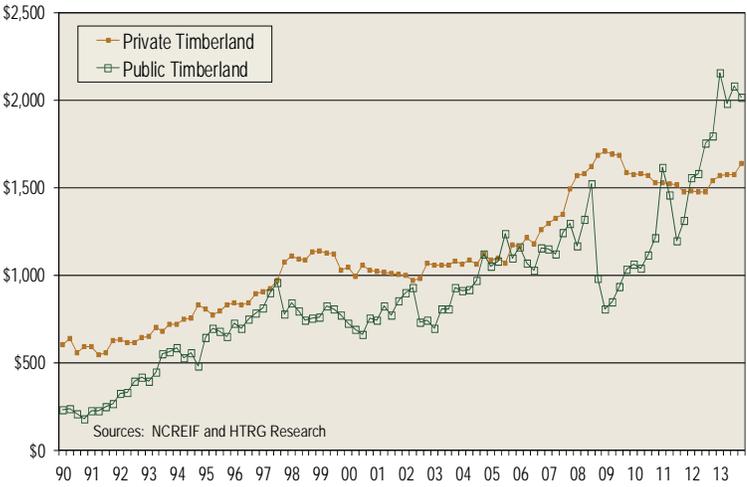


Figure 9. Timberland Enterprise Value

Timberland held in private financial ownership in the South averaged \$1,637 per acre in the fourth quarter, an increase of 6 percent from a year ago. Public timberland values, at \$2,017 per acre, rose 12 percent from a year ago. The spread between public and private timberland in the South has widened since year-end 2011, when these timberland values were about equal. Share price gains for public companies with wood products divisions have benefitted from increased production and rising lumber and panel prices since 2011. In contrast, timber prices in the South have yet to respond to the increased demand. Private timberland valuations are based in large part on third-party appraisals, submitted by timberland managers who contribute to NCREIF’s database. Public timberland valuation estimates are based on our measure of timberland enterprise values for five timber-intensive publically traded timberland companies calculated on a southern equivalency (see Notes section on page 6 for detail).

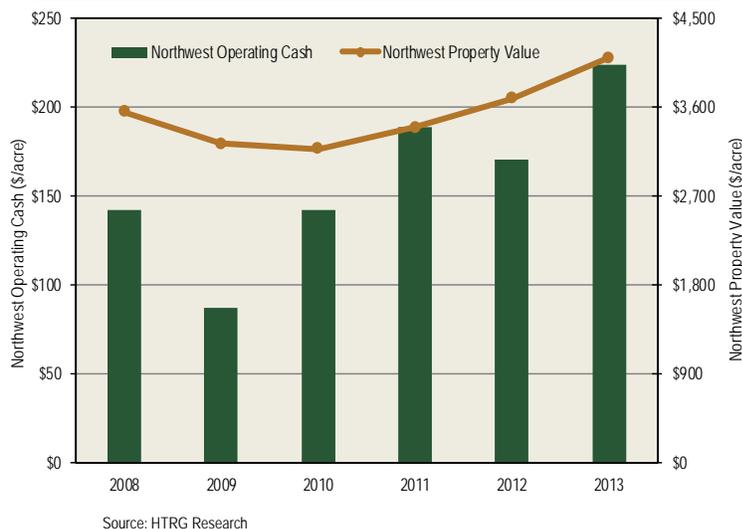
values documented by appraisals and transaction evidence over the past three years (Chart 2, page 2).

The changes in the Northwest sample have introduced some distortions into the calculation of timberland value per acre based upon the NCREIF database. Without the ability to freeze the sample of properties within the Index, large changes to its composition – age and stocking of the timber inventory, access to markets, or the overall quality of the timberland – make comparing the timberland value per acre metric over time difficult.

To provide an alternative measure of per-acre timberland values, we have utilized a fully regulated forest model, which attempts to hold constant the sample size and any changes in inventory. More description of the methodology can be found in our 2Q 2002 Hancock Timberland Investor newsletter or the December 2004 issue of the *Journal of Forestry*².

The estimate of market value per acre for the Northwest based upon the regulated forest model shows a trend that more closely corresponds to the capital returns from the region (Chart 3) – where market values per acre bottomed

Chart 3: Operating Cash and Value for Fully Regulated Northwest Timberland Property



in 2010, and have appreciated annually each subsequent year – with timberland values rising 11.3 percent from 2012 to 2013. These estimated Northwest timberland per acre values are consistent with what we have seen in timberland appraisals and transaction evidence in the region over the past three years. 🌲

End Notes

¹<http://www.ncreif.org>

²Aronow, M.A., Binkley, C.S., Washburn, C.L. 2004. Explaining Timberland Values in the United States. *Journal of Forestry*. Volume 102, No 8.

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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 - 60percent MGP 10 90x35x4800, 40percent 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 50percent Domestic Douglas-fir (47percent #2 and 53percent #3 Sawmill sorts) and 50percent Whitewoods (47percent #2 and 53percent #3 Sawmill sorts). U.S. South prices are published by Timber Mart-South (60percent Southern Pine Sawtimber and 40percent 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 60percent U.S. South and 40percent 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.