

Timberland Investor Report

Cautious Optimism for U.S. Housing

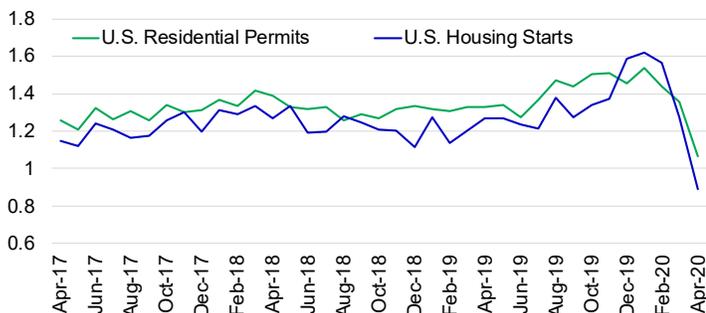
The key economic driver of timber demand and values is residential construction activity, including both the construction of new homes and repair and remodeling of existing units. U.S. home building statistics for March and April charted a severe set-back for home construction as the disruptive economic impacts of the COVID-19 pandemic rippled through the sector. In April, building activity as measured by housing starts dropped precipitously (30 percent y-o-y) as did surveys of builders' sentiment. Despite the sharp reversals in the construction sector in mid-March and April, recent data releases (housing permits, builders' sentiment, and home prices) hint at underlying resilience in U.S. housing markets and the potential for an earlier recovery for residential construction and lumber and wood panel demand compared to other sectors of the economy.

After beginning the year strongly, home construction activity pulled back starting in mid-March as social-distancing, quarantines, business closures, and work-stoppages went into effect across the U.S. The statistics for April captured the impact of a full month under lock-down. U.S. new housing starts for April reported by the U.S. Census Bureau, dropped 30 percent from March, slipping from 1.276 million (SAAR) to 0.891 million SAAR. Compared to the same month a year earlier, April housing starts were also 30 percent lower than April 2019 (See *Chart 1: Monthly Housing Starts and Permits on page 2*).

April's drop in housing activity ranks as one of the sharpest month to month corrections since the 1950s. In the last major housing downturn in 2006-2009, the most pronounced month-to-month decline in housing starts was 16 percent in November of 2008. In the 2006-2009 U.S. housing correction, the 30 percent y-o-y adjustment that was just experienced this April, required a full 20 months to occur back then (February 2005 to October 2006) (See *Figure 1: U.S. Housing Starts on page 5*). Despite the exceptionally fast and deep drop in U.S. housing starts in April, a number of factors suggest that the depth and duration of the current correction in housing will not mirror the extended downturn in 2006-2009.

U.S. Housing Starts Show Major Historical Decline, While Forward-Looking Spring Permits for Residential Construction May Indicate Resilience in U.S. Housing Markets

Chart 1: Annual Rate of New Residential Construction Permits Authorized and U.S. Total Housing Starts (SAAR), millions



Source: U.S. Census Bureau, May 2020, NAHB May 2020

Compared to the last housing cycle, housing markets leading up to the COVID-19 triggered correction over the past two months were characterized by low inventories of homes for sale, more limited speculative building, and less over-extended home buyers.

Hopefully, the relative strong underlying demand for housing coupled with the proactive Federal government response to the economic dislocations of the pandemic (low mortgage rates and government fiscal programs such as the Payroll Protection Plan and temporary forbearance on mortgage payments) will support a more speedy recovery for housing. April's new home sales have held up well, at 623,000 (SAAR), a 0.6 percent rise over new home sales in March (619,000). Likewise, the inventory of new homes for sale in April is at a relatively normal six months' supply (reported at 6.3 months of supply in April, compared to 6.4 months of supply in March).¹

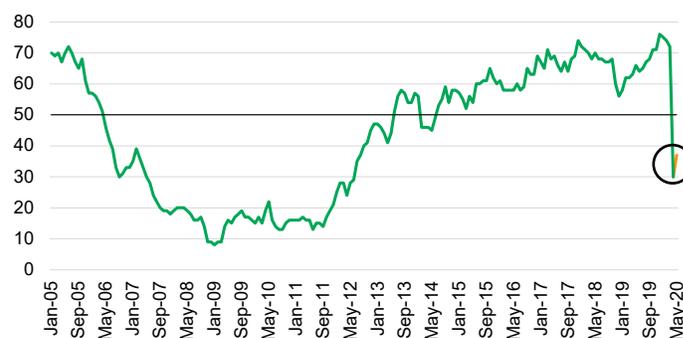
A possible sign of the potential resilience in U.S. housing markets was the more moderate downward adjustment in housing permits in April compared to the deeper drop in housing starts (See Chart 1: Annual Rate of New Residential Construction Permits Authorized and U.S. Total Housing Starts). Housing permits are a more forward-looking measure of construction activity than housing starts. New residential construction permits include five phases of a residential construction project: housing units authorized to be built by a building or zoning permit; housing units authorized to be built, but not yet started; housing units started; housing units under construction; and housing units completed. The scope of this measure of building demand spans the initial building intent where a permit is pulled all the way through to completion.

In April, permits declined 21 percent from the previous month, compared to the 30 percent correction for housing starts, suggesting that some stabilization may be taking place in residential construction activity.

The tentative positive message imbedded in the April housing permit statistic received corroboration from the May release of the National Association of Homebuilders/Wells Fargo Housing Market Index (HMI), which tracks builder sentiment in the U.S single family home market. After plummeting in April, the HMI turned positive in May. The HMI surveys National Home Builder Association members regarding market conditions for the sale of new homes at the present time, the level of traffic of prospective buyers of new homes, along with rating market conditions in the next six months, providing an assessment of current and future new-housing demand. April's survey, conducted April 1 to April 13, registered the most rapid fall experienced since the inception of the HMI (the survey dates back to January 1985). This plunge in builder sentiment was followed in May by a 7 point improvement, moving the HMI to a reading of 37. Although the improved May reading is a hopeful sign of some stabilization in housing markets, anything below 50 is still considered negative market conditions.

National Home Builder Sentiment Turns Upward, After Falling off Sharply in April

Chart 2: NHB/Wells Fargo Builder Sentiment Index (50+ is Good)



Source: NAHB, May 2020

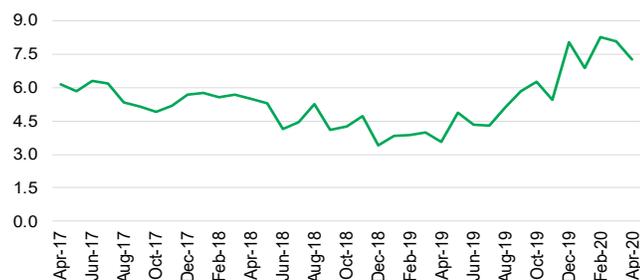
Another recent sign of resilience in current housing markets has been the continued strength in home prices. Although the rate of increase in the price of existing homes has moderated a bit from the highs reached in late 2019 and the beginning of 2020, home prices remain strong (See Chart 3, Median Sales Prices of Existing Homes, Percent Change on page 3). Responding to the economic uncertainty created by the pandemic, homeowners who were contemplating putting their residences up for sale have pulled back from offering their properties until social-distancing is relaxed and the economy regains forward momentum.²

¹Calculated Risk, <https://www.calculatedriskblog.com/2020/05/new-home-sales-at-623000-annual-rate-in.html>

²Wall Street Journal, May 6, 2020

U.S. Home Prices Are Holding Up Relatively Well in Major Markets

Chart 3: Median Sales Prices of Existing Homes, Percent Change



Source: Macrobond May 2020

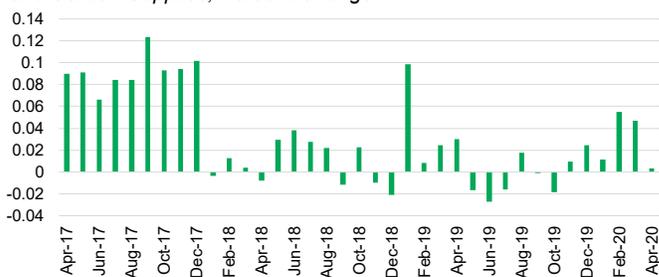
Strong demand for building products for home improvement projects during the pandemic has partially off-set the contraction in lumber and wood panel demand due to decreased construction of new homes. Mandated stay-at-home orders has spurred homeowners to focus on their living space, thinking of ways to make their homes more functional and accommodative for: work-from-home, workout-from-home, and educate-at-home. Living through the current pandemic with the expectation of possible future incidents requiring residents to be once again restricted to their homes, have some homeowners finding a new appreciation of their living-space.

These pandemic lifestyle and behavior changes should keep household investment in creating improved indoor and outdoor space trending higher. The U.S. Census Bureau's estimate of spending for building material and garden supplies continued to show relative strength, with April spending down just 3 percent from March spending (See Chart 4. *Monthly Dollars Spent on Retail Sales of Building Materials and Garden Supplies, Percent Change*). The positive impact of the pandemic on home repairs has also been a key driver of the strong performance of Home Depot and Lowe's share price, both of whom have out-performed the broad equity markets and are far ahead of most U.S. retailers.³

Uncertainty remains high regarding the timing and path of recovery from the down-turn in the housing market due to the pandemic, but the recent behavior of housing permits, builder sentiment, and repair and remodeling markets provide some basis for optimism looking forward.

Relative Strength Maintained in April Retail Sales of Building Materials and Garden Supply

Chart 4: Monthly Dollars Spent on Retail Sales of Building Materials and Garden Supplies, Percent Change



Source: U.S. Census Bureau, May 2020

The outlook for wood building products and timber will also benefit from the solid housing market fundamentals in place leading into 2020.

In contrast to the housing collapse in 2006-2009, when an overbuilt and over-leverage housing markets took years to unwind, the U.S. housing supply is relatively tight (based on low inventories and low vacancy rates) and lending standards have been much more stringent in the past decade compared to the mid-2000s.

With the exception of the last recession, which was triggered by the bursting of the mid-2000s housing bubble, residential construction has traditionally played a major role leading the economy out of recession. The National Association of Home Builders reported that building 1,000 average single-family homes creates 2,900 full-time jobs and generates approximately \$110 million in taxes and fees, which feed into local municipalities; and \$10 million in remodeling expenditures generates 75 jobs and roughly \$3 million in taxes.⁴ Given the Federal Reserve's commitment to keep interest rates low and credit available, housing will be well positioned to be an early contributor to an economic recovery.

³Wall Street Journal, May 21, 2020

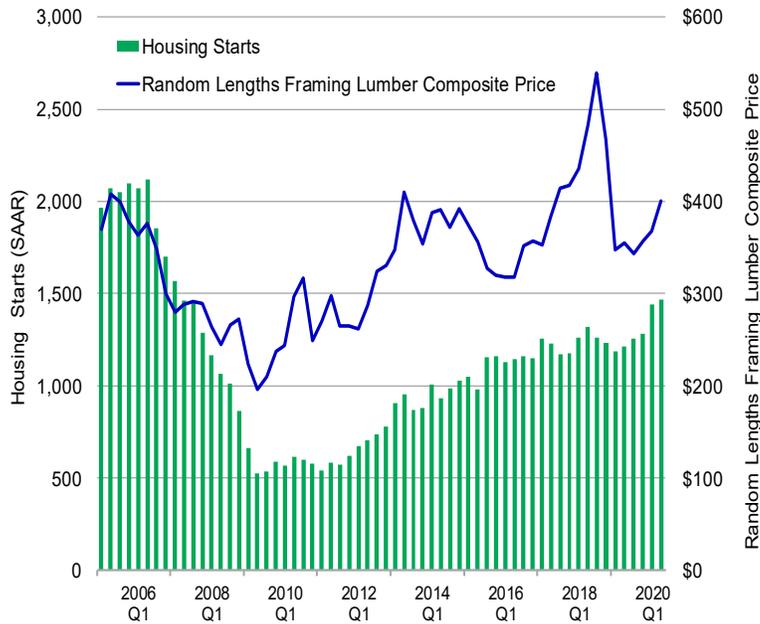
⁴National Association of Home Builders, May 2020

Timberland Market Indicators

Data as of 3/31/2020

Strong Start to 2020 for Housing and Lumber

Figure 1: Quarterly U.S. Housing Starts ('000s units) and U.S. Softwood Lumber Composite Price (USD per MBF)

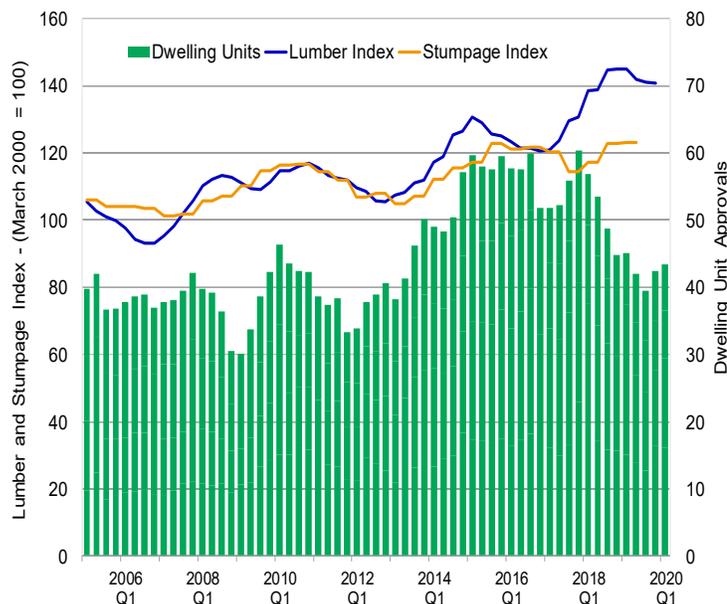


Sources: Random Lengths Lumber Report March 2020, U.S. Census Bureau March 2020

U.S. housing starts remained strong through March of 2020, at 1.466 million units (SAAR), a 1.5 percent increase over fourth quarter 2019. First quarter total housing starts were 22 percent higher than a year earlier and the highest quarterly level since the third quarter of 2007. April housing starts, not reflected in the first quarter starts, turned down 30 percent (See page 1). The Random Lengths Composite Index gained 3 percent first quarter over the fourth quarter of 2019 and was up 6 percent compared to the same period a year earlier. Lumber prices were supported by healthy late-season construction demand, and production curtailments and mill closures in British Columbia

Australia First Quarter Dwelling Approvals Increase Slightly

Figure 2: Australian Softwood Lumber AUD Price, Timber AUD Price and Dwelling Unit Approvals ('000s units)



Sources: Australia Bureau of Statistics March 2020, KPMG June 2019, Indufor Timber Market Survey December 2019

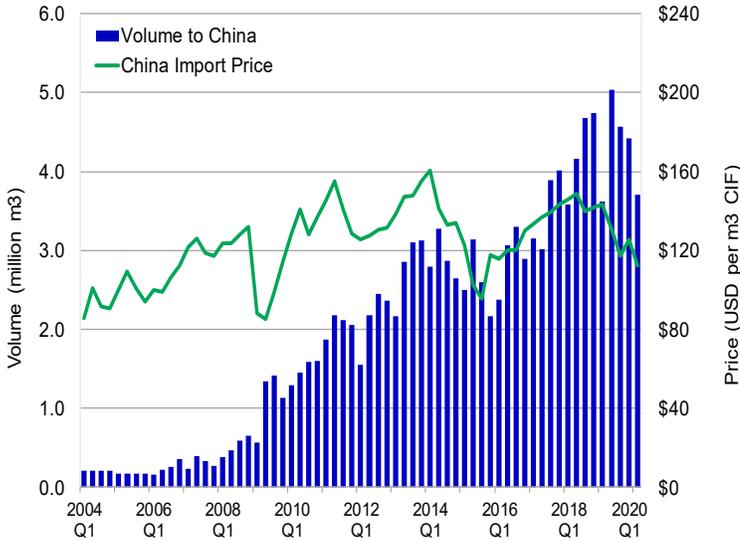
In the first quarter of 2020, Australian dwelling approvals (a key indicator of residential construction activity) increased slightly, rising by 2.2 percent from the previous quarter but were down 28 percent from the cyclical peak set in the final quarter of 2017. According to the Australian Bureau of Statistics housing starts were not impacted by the COVID-19 pandemic in March. However housing starts are expected to head lower as the effects of the pandemic are felt in the economy. The data reported for Australian structural lumber prices for December 2019 (latest data available) showed a slight decrease in prices from last quarter. Australian lumber prices at their current elevated level are vulnerable to a downward price correction, given the sustained retreat in housing activity. Australian sawlog stumpage prices are normally reported biannually, and the data reported as of June 2019 was flat with the previous quarter.

Timberland Market Indicators (continued)

Data as of 3/31/2020

New Zealand Log Export Volumes to China Fall Sharply

Figure 3: Quarterly New Zealand Softwood Log Export Volume to China (million m³) and Price in China (USD per cubic meter CIF)

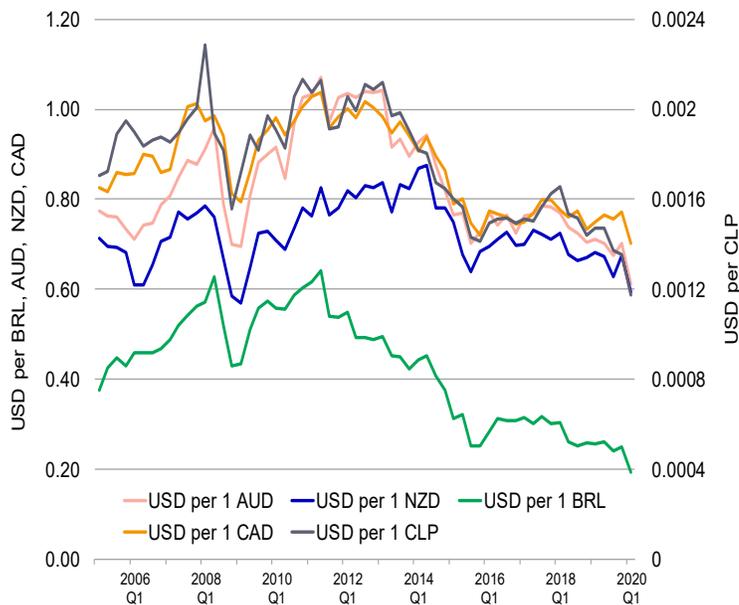


Source: Wood Markets International Inc. March 2020

In the first quarter of 2020, New Zealand log export volumes fell 16 percent from the fourth quarter of 2019 to 3.7 million cubic meters. The decline in exports was not unexpected due to the seasonal effect of the Chinese New Year in February, combined with New Zealand's country-wide shutdown of forest operations due to the pandemic. Compared to the same period last year, exports were up 2.4 percent. Prices for New Zealand radiata pine logs imported into China declined by 11 percent from last quarter and 22 percent from last year as a result of a buildup of inventories at China's ports.

U.S. Dollar Acts as Safe Haven Currency

Figure 4: Quarterly Exchange Rates Between USD and Commodity Currencies



Source: Macrobond March 2020

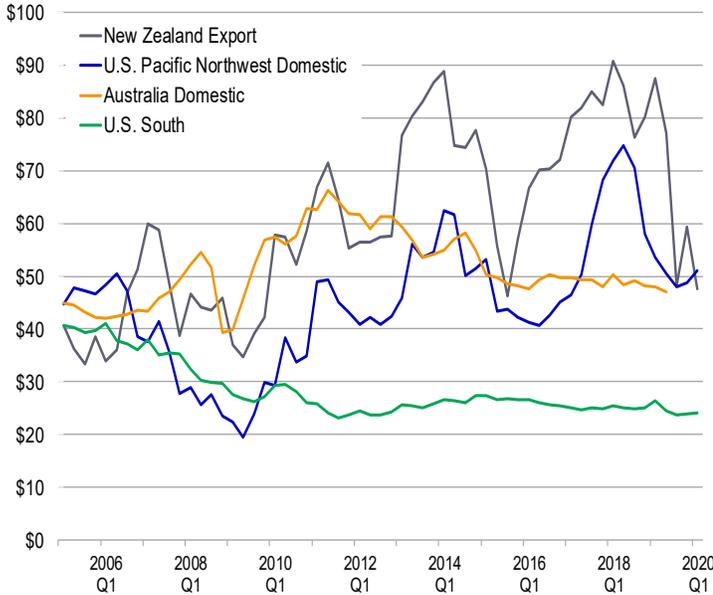
The U.S. Dollar appreciated against competing currencies in the first quarter of 2020 as it acts as a safe haven currency during the pandemic. Compared to the prior quarter, the U.S. Dollar appreciated: 6 percent compared to the Australian Dollar; 13.8 percent relative to the Canadian Dollar; 13.0 percent relative to the New Zealand Dollar; 24.9 percent relative to the Brazilian Real and 20.1 percent compared to the Chilean Peso.

Timberland Market Indicators (continued)

Data as of 3/31/2020

New Zealand Softwood Log Prices Retreat, U.S. Southern Pine Prices Remain Flat

Figure 5: Regional Softwood Sawtimber Stumpage Prices (USD per cubic meter)

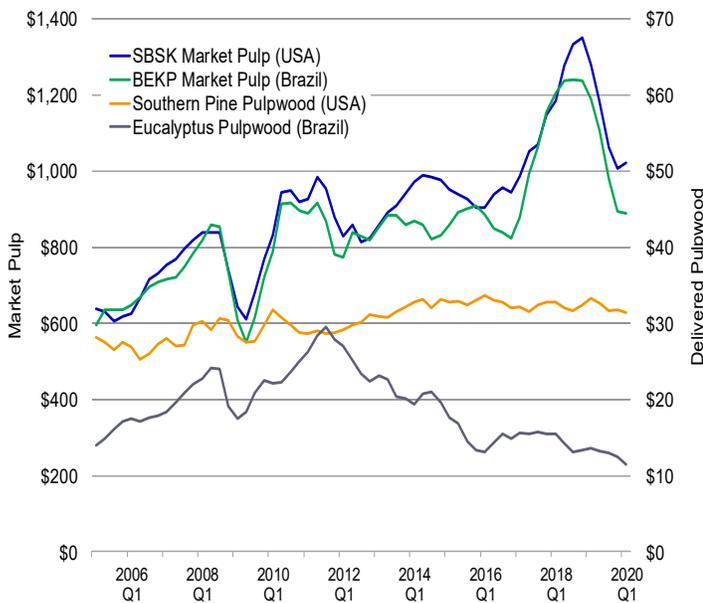


Sources: Log Lines March 2020, Timber Mart-South March 2020, NZMPI and Agrifax January 2020, KPMG June 2019

New Zealand softwood sawtimber prices in the first quarter of 2020 decreased 20 percent from the previous quarter and were 46 percent lower compared to the final first quarter of 2019. With China being New Zealand's largest market for export logs, the pandemic took a large toll first quarter on New Zealand, first with China's abrupt and severe lock down following Chinese New Year as the pandemic took hold, and followed by New Zealand declaring forest operations as non-essential services, halting forest operations. U.S. Pacific Northwest sawtimber prices increased by 4.5 percent as a result of strong housing starts in the first quarter, but were down 4.8 percent from a year earlier. In the U.S. South, southern pine stumpage prices remained fairly stable with the previous quarter yet were down 8.5 percent from last year. The most recent release of Australian pine stumpage prices was for June 2019.

Global Pulp Inventories Weigh on Prices

Figure 6: Quarterly Prices for Market Pulp and Delivered Pulpwood (USD per metric ton)



Sources: Hawkins Wright March 2020, Timber Mart-South March 2020, STCP March 2020

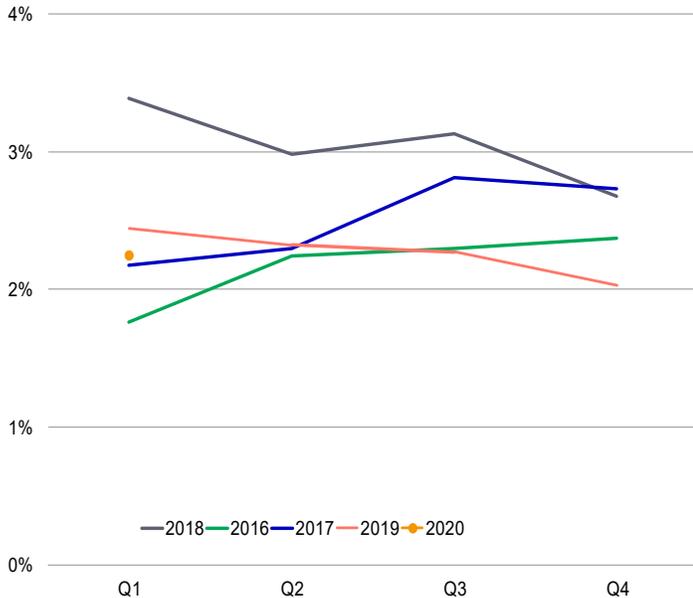
Slower growth in China's overall economy had contributed to a build-up in pulp inventories and put downward pressure on global pulp prices going into the first quarter. Compared to the previous quarter, Bleached Eucalyptus Kraft Pulp (BEKP) prices dropped 0.6 percent while Southern Bleached Softwood Kraft Pulp (SBSK) prices rose 1.6 percent. In the first quarter of 2020, BEKP prices were down 25 percent from the same period a year earlier, while SBSK prices declined 20 percent over the same period. Pine pulpwood delivered prices in the U.S. South were down 1.5 percent from the previous quarter and by 5.8 percent from last year. Brazilian Eucalyptus delivered pulpwood prices (in USD) declined 2.4 percent from the previous quarter and were down 11 percent from last year.

Timberland Market Indicators (continued)

Data as of 3/31/2020

Cash Yields in 2020 Near Historical Average for the First Quarter

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

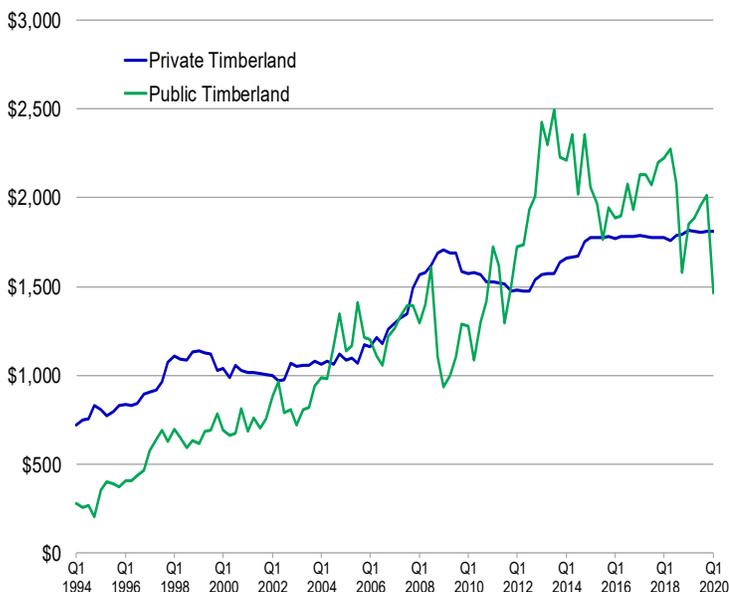


Sources: NCREIF March 2020, HNRG March 2020

In the first quarter of 2020, timberland cash yields reached an annualized rate of 2.3 percent, which was close to the average (2.4 percent) for the first quarter over the last four years. Second quarter cash yields are expected to be below average as operations in the U.S. respond to regional stay-at-home orders due to the pandemic.

Public Timberland Values Register Historical Decline

Figure 8: Quarterly U.S. South Timberland Values (USD per acre)



Sources: NCREIF January 2020, HNRG January 2020

Note: Hancock Timber Resource Group is a participating member in the NCREIF Timberland Property Index. The Index requires participating managers to report all eligible properties to the Index. Usage of this data is not an offer to buy or sell properties.

In the first quarter of 2020, the value of privately-held timberland in the U.S. South remained at \$1,813 per acre. Comparatively, southern timberland held by public companies, and measured by the Timber Enterprise Value per Southern Equivalent Acre (TEV/SEA) fell 28 percent, to \$1,465 per acre. This marks the second largest quarter-over-quarter decline since the TEV/SEA was constructed in 1994. Dragging down public company timberland values was the broad decline across public equity markets that occurred at the close of first quarter.

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About Hancock Natural Resource Group

Hancock Natural Resource Group, Inc. is a registered investment adviser and part of Manulife Investment Management's Private Markets platform. We specialize in global farmland and timberland portfolio development and management on behalf of our investors worldwide. Our timber division manages approximately 6 million acres of timberland across the United States and in Canada, New Zealand, Australia, and Chile. Our agricultural investment group oversees approximately 300,000 acres of prime farmland in major agricultural regions of the United States and in Canada and Australia.

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Notes Timberland Market Indicators

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. Random Lengths Lumber Report is used for lumber prices.

Figure 2. Quarterly Australian Dwelling Unit Approvals is published by the Australian Bureau of Statistics. The Lumber Index is published by Indufor 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 FEA Wood Markets Monthly Inc.

Figure 4. Monthly average Exchange Rates are from Macrobond.

Figure 5. Quarterly Softwood Sawtimber Stumpage Prices for the U.S. Pacific Northwest is reported in Loglines published by Fastmarkets 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 Agri-Fax A and K log sort prices and A,K and J log prices 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. Public equity values are derived from our Timberland Enterprise Value per Southern Equivalent Acre (TEV/SEA) calculation for four 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.

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