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# Timberland Investor Report

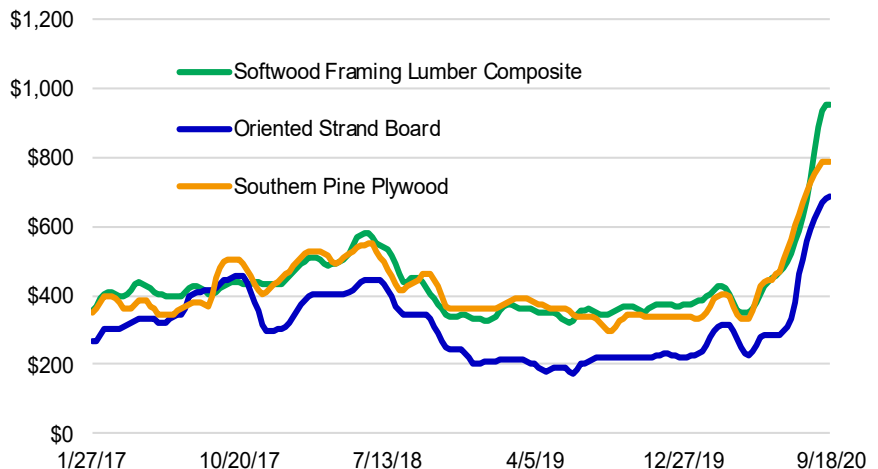
## Unexpectedly Strong Recovery in Housing and Forest Products Bodes Well for Post-COVID Timber Markets

*An explosive rebound in construction activity and solid wood products markets is helping lead the U.S. economy out of the COVID-downturn. An unexpected combination of surging new home construction and home remodeling coupled with tight supplies has boosted solid wood product prices to record levels. Prices for lumber and wood panels in North America at the beginning of the third quarter are at historic highs. The current run-up in lumber and wood panel prices has resulted in outsized profits for solid wood producers and retailers, and is currently moving U.S. timber prices higher, although with significant differences in magnitude across the various regions.*

In the *Timberland Investor Report* published earlier this year (May, 2020), we noted that recent U.S. housing market statistics - housing permits, housing starts, builders' sentiment, and home prices - suggested underlying resilience in U.S. housing markets, pointing to an early recovery for residential construction

### U.S. Lumber and Panel Prices Soar Amidst the Pandemic

Chart 1: US\$ per MBF (Lumber), per MSF (Plywood and OSB)



Source: Random Lengths, September 18, 2020

and lumber and wood panel demand compared to other sectors of the economy. These early indicators proved directionally correct, but the magnitude of the surge in residential construction activity was underestimated along with the resultant strength of building product prices. The magnitude of the price increases for lumber and wood panels has surpassed expectations. The Random Lengths softwood composite Framing Lumber Index reached \$955 per MBF the week of September 18, 159 percent above the price during the same week of September last year, and \$375 per MBF higher than the last peak price in the spring of 2018.<sup>1</sup>

Early in the COVID crisis when states announced stay-at-home orders, forest product manufacturers anticipated a collapse in demand and quickly responded, sharply curtailing mill operations in March and April. North American lumber mills cut production by an estimated 19 percent in March and April while Oriented Strand Board (OSB) and plywood output temporarily dropped 15 percent.<sup>2</sup> Most states deemed the building sector an essential business, allowing construction to continue, which helped support building product demand. Production cuts and supply chain disruptions amidst continuing demand caused inventory imbalances and lifted prices.

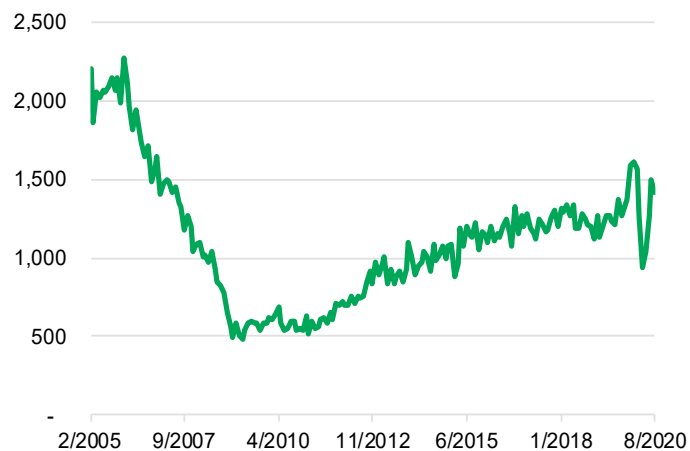
### Pent up U.S. Housing Demand and the COVID-generated Demand for Re-configured Living Space

Manufacturers' fears of a sustained set-back in building product demand did not come to pass. New home construction activity was fueled by easing monetary policy which pushed mortgage rates down to historic lows, while the pandemic environment accelerated changes in consumer preferences and behavior. Home buyers became motivated to consider moving to more suburban and rural locations when confronted with fears of contagion, they increased focus on family, and more intense use of homes for work-space, education and child-care, with an enhanced technological ability to work at a distance from offices. Additionally, many homeowners also undertook extensive renovation projects to accommodate their living-spaces to a more home-bound life-style. Builders were also able to shift their focus away from the heavily developed and highly-priced urban areas to less developed markets with a greater potential to obtain buildable lots.

Housing starts fell to 934 million units, SAAR, in April, but housing demand quickly bounced back, and by June were back to pre-COVID levels. Residential construction benefitted from falling interest rates, strong pent up demand, and government transfer payments boosting personal income. By August, total U.S. housing starts reached 1.42 million units, SAAR, a 51 percent increase

## U.S Housing Starts Bounce Back to Pre-COVID Levels

Chart 2: Monthly U.S. Total Housing Starts, SAAR, Millions



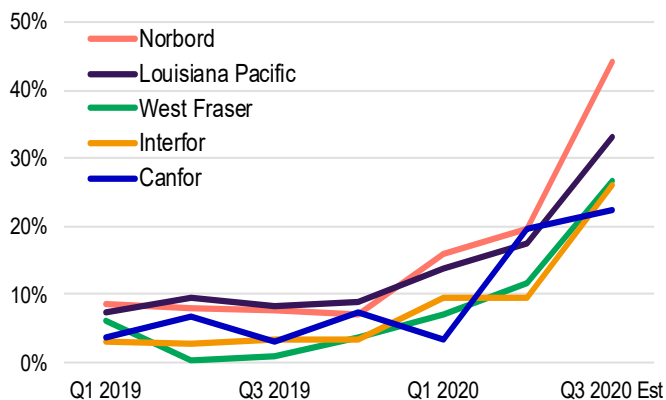
Source: Macrobond, September 17, 2020

from April's bottom. This strong bounce back has validated the pent up demand for new homes in the U.S which has lingered since housing markets collapsed during the Global Financial Crisis when total housing starts bottomed in 2008 at 0.478 million units SAAR, 376 percent below the previous peak of 2.27 million units in 2006.

Since May, lumber and panel mills have been running as hard as they can, taking advantage of the strong demand and surging prices for lumber and panels. *Forisk* reports

## North American Lumber and Panel Producer Profits Soar

Chart 3: EBITDA, Adj, Margins (percent)



Source: Bloomberg, September 17, 2020

at least 109 sawmills across Canada and the U.S. increased production after curtailing in March and April.<sup>3</sup> The run up in lumber and panel prices has put producers and home center businesses in a cash-rich position. Looking at financial results of top lumber and panel

<sup>1</sup> Random Lengths, August 2020

<sup>2,3</sup> Forisk Q3 2020

producers in North America, on an adjusted EBITDA basis, results show out-sized profits in the 1H of 2020, and analysts expect further gains in the third quarter.<sup>4</sup>

With wood product prices at these levels, even high-cost facilities can produce profitably at near-capacity. Capital investments in facilities are continuing, and capacity expansions and additions have been announced and are moving forward.

High prices for lumber and panels have motivated overseas suppliers to direct more softwood lumber shipments to the U.S. in 2020. Year-to date in July, U.S. imports of softwood lumber from overseas (non-Canadian) suppliers have increased 33 percent, rising to 1055.8 million board feet,<sup>5</sup> which on an annualized basis represents approximately 4 percent of U.S. lumber demand and is the highest volume level since 2006.<sup>6</sup> European lumber producers are faced with poor home-country demand and an oversupply of salvage timber. Forests in Central and Eastern Europe are contending with beetle infestations and wind throw events that have boosted harvest levels over the last year, and this excess timber production has lowered wood costs for European lumber producers who are finding a home for their increasing out-put in the strong U.S. market.

U.S. imports of softwood lumber from European supplying countries increased 47 percent in the first 7 months of 2020, compared to the same period in 2019. Softwood lumber shipments from Germany, topped the import list, with 368 million BDFT shipped through July, accounting for 35 percent of total non-Canadian imports for the Jan-July 2020 period. Canada, the largest cross-border supplier of softwood lumber to the U.S. has struggled to hold onto its share of the U.S. market. Timber harvest limits on British Columbia forests set by the Provincial government have resulted in permanent mill closures and

## U.S. Softwood Lumber Imports Surge From Non-Canadian Suppliers

Chart 4: U.S. Softwood Lumber Imports (Million BDFT)

	2020	2019	
	Jan - July	Jan - July	% change
Europe	726.4	493.8	47%
South/Central America	224.2	209	7%
<b>Total Non-Canadian</b>	<b>1055.8</b>	<b>794.2</b>	<b>33%</b>
Canada	7027.1	7676.9	-8%

Source: ITC Global Trade Map, September 17, 2020

boosted costs of production compared to other lumber producing regions. Canada has shipped 8 percent less softwood lumber year-to-date through July 2020 to the U.S. than in the same period last year.

Currently, lumber and wood panel prices are not sustainable, but mill inventories are at the low-end of their historical range and recent fires in the Pacific Northwest and storms in the South have added additional disruptions to the supply pipeline, which should support prices entering into the final quarter of 2020.<sup>7</sup> Lumber and panel prices are expected to retreat by the end of the fourth quarter, with slower buying and seasonal weakness, and as producers continue to pump out products to take advantage of still healthy profit margins.

## Differing Price Results Across Timber Markets

The strong end product prices have not uniformly transferred back to timber prices across the various U.S. supply regions. As residential construction demand and repair and remodeling demand resumed strength in May and June, the tighter log supply/demand balance in western forests quickly translated into stronger timber prices in the second quarter of 2020. Timber prices in many areas in the western U.S. during the second and third quarter have increased \$100 - \$200/MBF above prices in the first quarter this year. In contrast, the extensive timber inventory of mature southern pine sawlogs in the southern U.S. has held pine sawtimber prices in check. Despite southern pine lumber production increasing by 8.2 percent in the first quarter of 2020 compared to the same period a year earlier, very little movement in southern pine timber prices has occurred. The relatively low-wood costs in the US South are resulting in exceptional margins at existing lumber and plywood mills at this time and are motivating another round of capacity expansions. The South continues to lead North America in sawmill investments, with more than \$1.9 billion in announced projects for over 4.8 BBFT of capacity.<sup>8</sup> Surprisingly, the COVID crisis is triggering new capacity announcements in the U.S. South which should improve prospects for the region's timber prices in the coming years.<sup>9</sup>

<sup>4</sup>Bloomberg, September 17, 2020

<sup>5</sup>Random Lengths International, September 17, 2020

<sup>6</sup>RISI June 2020, HNRG Research, September 20, 2020

<sup>7</sup>FEA Lumber Market Outlook, September 11, 2020

<sup>8</sup>Forisk Q3, 2020

<sup>9</sup>FEA, September 21, 2020

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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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