

Investment Opportunities in Timberland & Timberland REITs

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An investment in timberland or timber REITs (Real Estate Investment Trusts) may provide a compelling opportunity at this time due to numerous attractive characteristics, including inflation protection, growth, exposure to the development in emerging economies around the globe, and tax-efficient income in the case of timber REITs.

For the past few years timberland prices in the U.S. have been depressed, primarily as a result of the housing collapse. Secondly, there has been a glut of supply from Canada in recent years due to an insect epidemic, which has forced Canadian timberland owners to harvest more than normal. Now, both of these variables have ceased to depress the market and timber prices have been steadily appreciating, improving the outlook for investment in timberland and timber REITs.

New home sales in the U.S. are about as low as they can possibly go, having declined by 85% from the peak in 2006. The current level of 300,000 annualized housing starts is unsustainably low – it is far below the long-term production of new housing units that is necessary to absorb the 4 million person increase in the U.S. population that occurs each year. This does not mean that home prices have bottomed, only that starts for new housing units likely have. It is unit volume, not price-per-unit, which ultimately matters from the perspective of an investment in timberland or timber REITs. Furthermore, it is expected that the Canadian over-supply situation will end by 2011. Even in the absence of an improvement in the U.S. housing market, the decrease in supply from Canada will result in increased demand from domestic timberland sources, and it is reasonable to expect a substantial increase in lumber prices going forward.

Over the long-term, global consumption of wood-based products is strongly correlated with two variables: population and wealth. The global population is expected to increase by an additional 1.4b people in the next 20 years, and the emerging economies of the world are experiencing rapid increases in wealth and living standards. As large populations in these developing countries, such as China, increase their per capita wealth, it is reasonable to expect that total wood consumption among emerging economies will increase and approach levels more consistent with developed economies, such as the U.S. and Japan.

Perhaps the most unique aspect of an investment in timberland or timber REITs is the organic growth, literally. Regardless of recession, depressed lumber prices, geopolitical turmoil, or other sources of investment risk, year after year, trees grow bigger. If you buy a barrel of oil and hold it for 5 years, you will still only have a barrel of oil. But if you buy an acre of timberland and wait for 5 years, the combined size of all trees living on that acre will have grown measurably, and you will therefore have more timber than you originally purchased. The timberland investment grows, biologically, and this enhances investment returns over the long term.

Timber REITs are of particular interest due to their high levels of tax-efficient income. Timber REITs, like other REITs, are required to pay out 90% of their annual income each year, and benefit by avoiding

corporate income tax in the process. To an investor in timber REITs, this dividend income is frequently classified as a long-term capital gain and is therefore taxed at the current rate of only 15% - much lower than most investors' marginal income tax rate. This makes timber REITs a great source of tax-efficient income. In recent years a handful of timber companies have restructured and elected to become timber REITs, providing investors with a new way to take advantage of both the attractive timberland market and the tax-favored nature of the timber REIT structure.

If executed properly, the relative success of an investment in timberland or timber REITs is not dependent on higher lumber prices or an improvement in the U.S. housing market. Instead, a timberland presents a compelling investment opportunity because it entails numerous attractive characteristics, including inflation protection, growth, leverage to emerging market economic development, tax efficiency, and substantial current income.