

The Rise (and Fall?) of TIMOs

Ownership Changes in US Forestland

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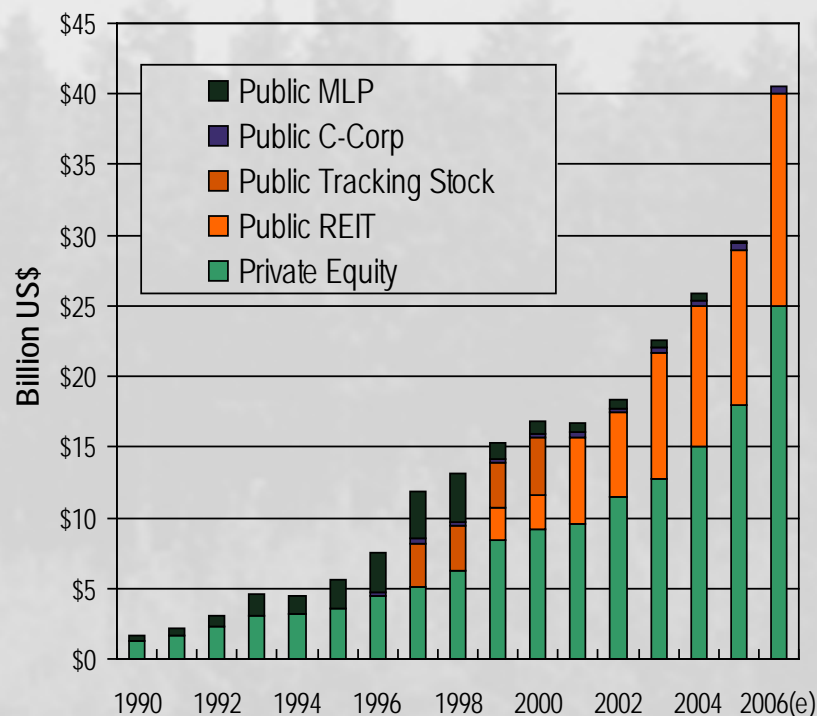
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Agenda

- I. A brief history of forest-sector dis-integration in the US**
- II. Why has this happened?**
- III. Some thoughts on the future**
- IV. Implications: why should we care?**

I. Dis-Integration of the US Forest Sector

- 20+%/yr change since 1980s
- A brief history:
 - First funds in 1970s: Travelers, Eastern Airlines; British Coal Board
 - Private equity grew out of farm lending
 - Securitization provided liquidity; protection: IP and Rayonier MLPs; Plum Creek spinout from BN



Source: HTRG Research

II. Why has this happened?

- **Good risk-adjusted returns from timberland as a stand-alone asset: insights from academic research**
 - Total Return = 15.3% 1987-2005
 - Low correlation with other assets → diversification/low risk
 - Good inflation hedge, esp. for unexpected inflation
- **Accounting treatment for public companies**
 - According to American accountants, trees don't grow!
 - Even worse, they depreciate (v. IFRS)
- **ERISA of 1974: private pension funds *must* diversify**
- **Tax Treatment**
 - IRC 631(b): capital gains tax preference for individuals
 - IRC 631(b): passive income for tax-exempt institutions
 - REITs: no tax for “qualifying” corporations

III. Some thoughts on the future

- **TIMO/REIT growth in the US is just about over**
- **Lots of TIMO/REIT land will be sold in smaller parcels**
 - “HBU” sales ~ 1/3 total return?
 - Fixed-term funds started in the 1980s are winding down
 - “We’re eating our babies”—anonymous TIMO forester
- **Forward-looking returns are falling**
 - Timberland markets are more efficient
 - More capital pressing against a relatively fixed asset base
 - A plethora of TIMOs and private-equity funds have emerged
 - “Quality” of returns is deteriorating

IV. Why should we care?

- “Private-equity investing leads not only to value creation, but also to economic and social benefits, for example, increases in employment, innovation and research and development”
H. Kravis, 2007
- **What about the forest sector?**
 - Positive focus on forest management
 - Marked reduction in R&D
 - Ever more fragmented ownership (but not necessarily a more fragmented forest)
 - Investors susceptible to economic inducements
 - New-land planting in the US?
- **Meltdown scenario?**