Woodland Haven

U.S. Timberland Gets Pricey As Big Money Seeks Shelter

Rush Reflects Glut of Capital, Low Payoff on Other Assets; Sold: 5% of State of Maine But Do Trees Grow to the Sky?

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As money managers seek homes for today's profusion of investment capital, some are straying far from the canyons of Wall Street. Specifically, into the woods.

Private partnerships, real-estate investment trusts and other financial investors are snapping up millions of acres of forest land -- not just in America but in New Zealand, Uruguay, Brazil and beyond. They are buying from giant paper companies such as International Paper Co., which are under pressure from restless shareholders to boost their profits by cashing in on forest land that for decades has just sat there.

• Huge Flood of Capital to Invest Spurs World-Wide Risk Taking

The result is an enormous land transfer now under way. The paper companies long were the nation's largest private owners of large tracts of standing timber. "For 100 years, the industrial users owned this land. A 1980 map of landowners in Maine would be almost the same as the 1900 map," says William Ginn, an official of the Nature Conservancy, a nonprofit environmental group.

Now the national map changes almost monthly. It's a phenomenon that has financial ramifications as well as environmental ones, such as the possibility that financial investors who get in a bind might over-log or overdevelop the land.

Today, nearly $30 billion of American forest land is in the hands of financial investors, according to Hancock Timber Resource Group, a large timberland investment manager. That's six times what such investors' timberland holdings were in 1994, Hancock Timber estimates. And these investors have poured billions of dollars more into forests abroad.

In one notable sale, an investment partnership run by Grantham, Mayo, Van Otterloo & Co., a Boston money-management firm, last year bought more than 5% of the land in the state of Maine. Grantham Mayo oversees 2.6 million acres of timber investments world-wide.

Harvard University, meanwhile, earmarks 10% of its nearly $26 billion endowment for timber, a remarkable proportion for such a small and unconventional asset class as this. Although Harvard recently sold most of its U.S. forest holdings -- to another financial investor -- the university is looking for new land to buy. Yale also invests in forests, as do various pension funds, insurance companies and charitable trusts. John Malone, chief executive of Liberty Media Corp., owns 75,000 woodland acres with his wife.

The money pouring into timber reflects a global hunt for higher returns as investment cash floods the world from many sources: pension funds, central banks, hedge funds, oil-rich nations and corporations with surplus cash on their balance sheets. This has created a surge in demand for "hard assets" like real estate, timber and commodities -- in part because cash flooding into bonds has driven down returns on them.

NEW GROWTH

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Industry insiders say $10 billion more U.S. timberland will come to market over the next year or two, and that investors are lined up to buy it. The result of this fervor is that prices have climbed, in some cases doubling in five years, despite weakness in prices of the lumber the forests produce.

The trend leads a few investors to fret that a bubble could be forming. "I think there is a risk that that is either happening or may be on the verge of coming to pass," says James Nicol, a partner in an investment firm called Forest Systems. Most people in the business insist timberland prices are far from bubble territory.

With bond yields puny and stocks flat year-to-date, timber offers a shot at stable returns in the high single digits, mostly from long-term growth in the value of the land and its trees. Low interest rates make it cheap for an investor to borrow cash to magnify a bet on timber.

As a hard asset, timber also has appeal as a haven from possible worsening inflation that might undermine financial assets. And it has diversification value: Its market performance historically is largely uncorrelated with those of stocks and bonds -- when they zig, timberland may do nothing or may even zag.

But if the low interest rates that encourage timber investing go up, calculations could shift. Competing fixed-income investments would look more attractive. Home construction might slow and crimp demand for the lumber and wood fiber the forests produce. The cost of borrowing for land acquisition would rise. All this could weigh on land prices.

For environmentalists, such shifts could exacerbate concerns that they already have about financial investors' big ownership of forests: real-estate development and the potential of over-logging. As long as paper companies are the owners, the woods -- although logged periodically -- generally aren't closed off to hikers or wildlife, and prime forest sites don't


Bob Saul

turn into vacation-home lots. But for financial investors, the returns can come not just from wood but often partly from selling off bits of the forest for development. And environmentalists worry that if investors should face pressure and need to raise cash, some might be tempted to step up development plans or harvest the trees too frequently.

Already, "what we are seeing here in Maine is that there definitely is a spike in development," says Cathy Johnson of the Natural Resources Council of Maine, a group affiliated with the National Wildlife Federation. She and other conservationists are fighting a plan by Plum Creek Timber Co., a real-estate investment trust, for housing, resorts and stores on 9,000 acres near Moosehead Lake in central Maine. "Maine's North Woods is the largest undeveloped block of land east of the Mississippi," Ms. Johnson says. "The future of this area is being determined."

After initially endorsing the plan, selectmen of the lakeside town of Greenville came under local pressure and reversed themselves at an emotional meeting in August, deciding to remain neutral. Some said the project would support the weak local economy, while others feared it would close off land and mar the natural beauty, which draws visitors.

Plum Creek is redoubling efforts to convince local people its plan is environmentally friendly and good for the economy and tourism, emphasizing that it calls for developing just 9,000 of 426,000 acres the company owns in the area. The rest would be logged or conserved. "We believe that there is a really large ratio of public benefit for a small percentage of development," says a spokeswoman.

Financial investors maintain they're good stewards of the land. Under their watch, the forests are largely in the hands of people like Bob Saul, who manages a billion-dollar portfolio of timber investment for Grantham Mayo. Working in an office above a Mexican restaurant in Amherst, Mass., adorned with maps and forest photos, Mr. Saul scouts for land, negotiates sales and oversees management of woodland already acquired.

A decade ago, jobs like his barely existed. Mr. Saul had a chain of furniture stores that failed in the 1990 recession. He began managing commercial property and studied forestry. When the contrarian-minded Grantham Mayo created an arm to manage timber investments in 1997, it hired him.

The going was tough. Mr. Saul was hawking target returns of 8% to 10%, after inflation, at a time when stocks were rising 20% or more a year. "We ran around doing endless pitches to anyone from pension funds to endowments to wealthy individuals," he recalls. "They just laughed." He and colleagues were able to scrape together just $51 million for the firm's first timber fund, in 1998, and even less for a second one in 1999.

But after stocks cracked in 2000, dealing investors painful losses, some began looking elsewhere. Many retreated to the seemingly solider asset of real estate, sending it into orbit. Others turned to oil, industrial commodities or precious metals, all of which also soared, for various reasons including the boom in China. And some investors found trees.

The University of Minnesota, before the market retreat, had its endowment spread over a broad range of stocks, bonds and alternatives such as venture capital. But the 2000-2002 bear market still knocked more than a quarter off the endowment's value, and the dismayed university officials ordered an overhaul. "Although we thought we were diversified at the time, many of the asset categories we had were highly correlated," tending to rise or fall together, says Chris Suedbeck, the university's assistant director of asset management.

The university also realized that "our expectations on returns were inflated" in the go-go years, Mr. Suedbeck says. By the start of 2003, after nearly three years of stock doldrums, the 8% to 10% that seemed possible with a long-term commitment to timber looked pretty good. Today, the university has $18 million of its $770 million endowment in timber.

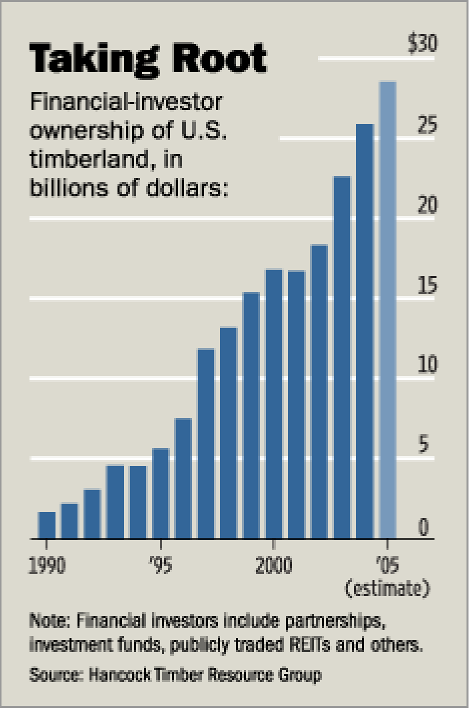
Last year, as demand heated up, Grantham Mayo's eighth timber fund drew 73 investors who put in $660 million -- four times what one formed the year before drew. Investors in its funds typically tie up their money for 10 years, hoping the projected return will materialize through a combination of appreciation, sales of lumber and wood fiber, occasional sales of real-estate lots -- plus the benefit of "leveraging" the overall bet through borrowed money. Grantham Mayo now is putting together a fund that Mr. Saul says could approach $2 billion.

When Weyerhaeuser Co. decided to sell 270,000 acres in Georgia, Scott Jones, co-president of a Boston investment firm called Forest Capital Partners, was among the first potential bidders to visit. As he and local managers made their way down forest roads, he asked how many others were coming. The answer: two a day for the next two dozen days. "I didn't spend a lot of time on that deal," says Mr. Jones, who didn't bid.

Mr. Saul, in his office on a recent day, punched into his laptop the data on a tract that was for sale: the age of the trees, their species, the distance to sawmills and pulp mills. The sale would be a public one. "I hate these kinds of deals," he said. "Somebody always comes in crazy, and somebody will come in crazy on this deal," driving the price way up.

Instead of projecting 8% to 10% annual returns, Mr. Saul now tends to talk to investors about 6% to 9% returns, since the prices he has to pay for the land are higher. In the deal he was complaining about that day, he won, but at a price that leaves projected annual returns at just 7%. He hopes to boost that by using low-cost loans for part of the purchase.

Last year, Mr. Saul acquired all of International Paper's Maine timberland. It amounted to 5.1% of the state's total acreage, more than all of Rhode Island.



He was able to buy it at an acceptable price, $243 million, partly because it wasn't auctioned. Mr. Saul heard through a business contact that some of the paper company's U.S. land might be available. After some general conversations with someone there, "the lightbulb went off in my head that they were talking about selling Maine." In private meetings, the sides reached a deal on price, on International Paper's ability to buy wood from the land in the future and on employment of forestry managers.

Some investors boost returns by selling conservation easements, in which they give up development rights to preservation groups such as the Nature Conservancy. The deals ensure that the land won't turn into lots or shopping malls, yet typically leave the landowner free to harvest logs. Mr. Saul is negotiating a $50 million to $60 million easement sale on Maine property.

Selling such easements can win favor with environmentally conscious investors such as foundations as well as with conservation groups. "If we were to tick them off by selling off a lot of sensitive habitats to the highest bidder, we would lose their good will," says Mr. Saul. Although he has sold land for development in the past, he says, he did so only after informing the Nature Conservancy and persuading himself this particular land was in an area already being developed.

Mr. Malone of Liberty Media has been buying land for more than a decade, in part, he says, to support conservation. He figures he and his wife have paid roughly $30 million for about 75,000 acres in northern Maine. They also own 650,000 acres of ranch land in the West. But now he says Maine woodland that fetched $200 an acre five years ago is up to $450 or $500. "The prices for some things I want to buy are way beyond anything that I think economics justify," he says.

Harvard's endowment recently rattled the timber-investing world by selling its entire U.S. forest holding. "That has to give you pause," says Mr. Nicol, the investor who worries about the market getting overheated. The buyer was Hancock Timber, part of Toronto's Manulife Financial Corp. It says it expects to generate an inflation-adjusted annual return of 6% to 10% on the property.

The deal unfolded one snowy day in Boston in February when the overseer of Harvard's timber investments, Andrew Wiltshire, had lunch with Hancock Timber President Daniel Christensen. Over a plate of Arctic char, Mr. Wiltshire was surprised to hear his companion offer to buy Harvard's entire U.S. timber holding. After five months of talks, they announced a sale covering 930,000 acres, at an undisclosed price that competitors estimate at up to $1.7 billion.

Mr. Wiltshire says he sold to lock in a gain on a much-appreciated asset, and intends to look for other land elsewhere. He says Harvard retains most of its forests outside the

U.S., including in his native New Zealand, where it is the second-largest holder of timberland.

Still, the sale was disclosed at almost the same time that International Paper announced plans to sell more of its U.S. forest holdings, and potentially its entire remaining 6.8 million acres. Meanwhile, another longtime timber investor, California Public Employees' Retirement System, has sold its U.S. holdings, notes Mark Wilde, a Deutsche Bank Securities analyst. He wrote a report called "What Does Harvard Know?" in which he posed the question: "Does this mark the top?"

Most timber investors say no, although few deny that paying today's elevated prices will limit investment returns somewhat. The rising U.S. timberland prices are pushing some buyers abroad. Says Grantham Mayo's Mr. Saul: "There aren't many wild frontiers. Eastern Europe is one. Russia is another. It is hard to find the undiscovered spot."

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