JIM RINEHART'S RESPONSE TO RECENT ARTICLES
November 8th, 2005

***U.S. Timberland Gets Pricey*, E.S. Browning, Wall Street Journal, November 4, 2005**

***REITS Spread to Timber Industry*, Chelsea Deweese, Wall Street Journal, November 4, 2005**

Dear Mr. Browning and Ms. Deweese:

Having been involved in the institutional timberland investment business since its inception more than 20 years ago, I read with great interest your respective articles on timberland investing. For the most part, I thought you talked to the right people and captured the essential issues very well – timberlands recent rise in popularity following the tech-bust, diminished return expectations in timberland, the concern of Conservation for fragmentation and development, etc. Ms. Deweese, I agree in particular with your observation that REITs are sensitive to softening wood products markets due to their addiction to high and steady current earnings. It is ironic that these new ownership vehicles are subject to precisely the same pressures that caused forest products companies to become timberland sellers. There are nuances to both of your articles that add to the irony and should give investors some reason for caution.

First, the actual risk of timberland ownership is greater than often perceived – and greater than investment managers like to admit:

- The real story is in supply. Production technology has increased available supply dramatically over the last decade. Plantation science has increased growth rates 4 to 5 times in some cases and there are "Walls of Wood" coming from every direction. At the same time, utilization technology has advanced so useful product can be manufactured from ever smaller diameters. Substitution from non-wood products also has an effect. What this means is that the assumptions about future log values that justify paying such high prices for timberland are frequently wishful thinking, resulting in a "blow and go" bidding mentality that pushes prices to the limit, with advisors trusting on time, management, luck, and early retirement to avoid the ultimate backlash.

- Much of timberland's value lies in an unknowable future. Distal cash flows have relatively low current value, even lower considering the inevitable unforeseen events that take place over long investment horizons. If the reason for buying timberland lies in a hot wood market, those logs had best be on the truck and on the way to the mill to take advantage of it.

- The argument that "they're not making more land" is valid, but some of that land is so remote and zoning regulations so tight that a real estate fall-back is not necessarily solid ground.

- What appears on the surface to be a reasonable price may hide significant downside risk. Manufacturers have been forced by their investors to sell timberlands, but forest products companies have been shrewd in learning that you don't have to own timberland in order to have it. The market is so competitive that buyers have in some cases agreed to supply agreements that still leave the seller in control – long-term minimum annual volume contracts at whatever market happens to be, management service agreements that deplete the bottom line, etc. Buyers, if they're not careful, may merely be paying the seller to continue to "own" the resource. And make no mistake –cycles shift and forest products companies will be happy to buy it all back if the price is right.

Second, there is a social cost to be paid. As reality pushes hoped-for returns lower and as new opportunities begin to beckon capital their way, timberland will be squeezed for all its worth and more. Most Timberland REITs now have real estate divisions and quiet refuge and public access will suffer. Worse, large ownerships that are fragmented for sale into smaller tracts are no longer managed on a landscape scale, giving Conservation severe heartburn. Still worse, pressure on return can lead to overly intensive management, soil loss, flooding, and other nasty things like draconian regulation. The deforestation of the Mississippi Delta upstream from New Orleans no doubt gave Katrina some help.

The upside of all this is that there is another big investor waiting in the wings that can level the field – large scale Conservation. Thus far Conservation has focused on spending its capital in retail transactions, waiting 6 months to 2 years after the big guys do the big deals, and then buying small pieces at big prices. This has given them the reputation of "Dumb Money." By partnering with financial investors at the front end of a transaction, they can employ their lower cost of capital where it can do some good. This will give the Conservation/financial investor partnership a competitive advantage in a bid and still save Conservation a lot of money.

In all fairness, Conservation has been burdened by philanthropic and government funding sources that are so sluggish that it has frequently had little choice but to play the retail game. But this is changing. I have recently spoken with investors who see much potential in the reforestation of the Mississippi Delta, and Katrina may well provide the political "charisma" to draw the necessary conservation capital their way.

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