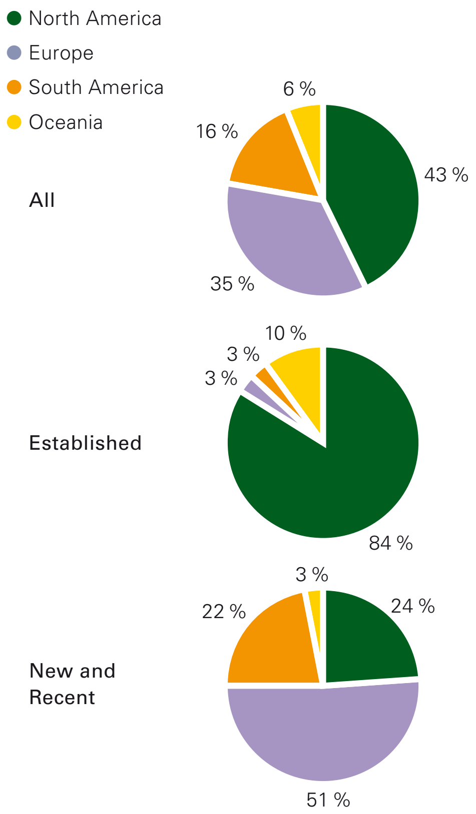
Issue no. 32. December 2010

IWC NEWS

TIMBERLAND FUNDS AND MANAGERS UNIVERSE

Thanks to 20 years of experience in the industry and an extensive network, The International Woodland Company (IWC) has a comprehensive knowledge of the timberland investment universe. The following is a selection of IWC's data regarding timberland fund managers, their fund offerings since 2007, and how much investable forestland is available worldwide.

Figure 1.
Managers' headquarters location



A GROWING NUMBER OF TIMBERLAND INVESTMENT MANAGEMENT ORGANIZATIONS

While relatively few 20 years ago, IWC now registers 88 timberland managers. These are defined as organizations that manage or have aimed at managing timberland funds for institutional investors (i.e. this article excludes organizations focusing only on retail investors, direct investments or separate accounts).

Among these, 29 managers (33 %) are today labeled as "established" (i.e. organizations that have been running a timberland management business for at least 5 years), 34 (39 %) are labeled as "recent" (businesses established between 2 to 5 years ago), and 25 (28 %) as "new" (companies set up within the last 2 years).

As shown in Figure 1, North America (all US but one observation) continues to be the principal domicile of timberland fund managers. However, over the last five years, there has been a significant increase of managers domiciled in Europe and South America.

New managers: reasons and challenges

IWC asked a number of new players why they decided to establish a timberland investment management organization and which aspects they find the most difficult when introducing their team and product to the market. The main outcomes are presented below.

- A fair number of new managers are spin-offs of established businesses due to divergence on how to run the company.
- Another key reason to form a new organization is to capitalize on a niche market, which is not currently offered by existing managers.
- Illiquidity and the apparent preference for seasoned managers with long track-records are considered to be the main difficulties encountered by newer managers.

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Figure 2. Number of funds and target equity per year[1]

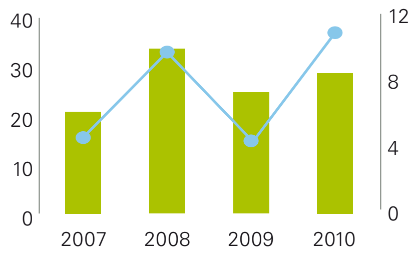


Figure 3. Share of investment strategies per year[1]

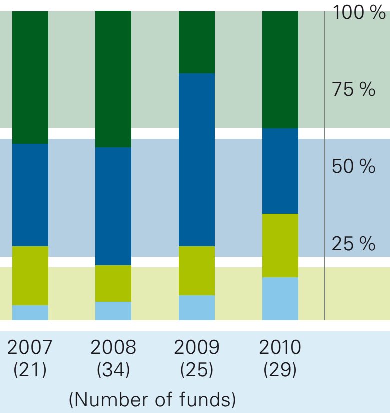


Figure 4. 2007-2010 funds by investment geographies

STATUS ON TIMBERLAND FUND OFFERINGS

IWC is aware of 109 timberland funds[2] that have been offered to institutional investors since January 2007.

Aggregated target equity size is in excess of USD 30 billion over the period, while actual capital committed is around USD 10 billion.

About 40 % of the funds have had a first or a final closing, nearly all of which have been offered by a manager with previous experience in timberland fund management.

Trends in fund investment strategies

For the purpose of this paper, IWC classified the different investment strategies offered into four categories:

- Established: Strategy focusing on regions, species and/or markets that are well known/developed (e.g. pine plantations in US South or in Southern Brazil, eucalyptus plantations in Chile, etc);
- Emerging: Strategy focusing on newer/less developed investment regions, species and/or markets (e.g. poplar plantations in the US or in Europe, teak plantations in Panama, sustainable management of tropical forest, etc);
- Mixed: Strategy combining established and emerging regions, markets, and/or species;
- PES: (Payment for Environmental Services): Strategy focusing on values other than purely growing timber (e.g. conservation easements, mitigation banking, etc).

As shown in Figure 3, over the last four years there has been a trend toward proportionally fewer funds focusing on the Established investment style, while proportionally more funds focus on PES strategies.

Update on target regions

In a similar manner, IWC looked into the funds' target geographies and decided to classify the funds into seven categories reflecting different risk/return expectations:

- 29 % North America: United States and Canada;
- 7 % Mature Latin America: Chile, Uruguay and Southern Brazil;
- 17 % New Latin America: All of Latin America, with the exception of Mature Latin America and the Amazon region;
- 6 % Europe: All of Europe except Russia;
- 7 % Oceania: Australia and New Zealand;
- 8 % Emerging Markets: Africa, the Amazon region, Asia and Russia;
- 26 % Multi-regional: Targeting at least two of the above defined geographies. Many of these are mandates to invest in Latin America as a whole, i.e. Mature and New Latin America together.

[1] The calendar year corresponds to when IWC first entered the fund in its database.

[2] Data presented in this article is as of October 30, 2010 and is derived from information IWC has received on 109 funds. However, specific data may not be available for all funds, e.g. Figure 5 "Real net target returns p.a. by target geography" is based on data from 82 funds.

Figure 4 shows that North and South America are the primary target destinations and that there is a significant share of broad mandates (Multi-regional funds, mostly offered by recent and new managers as defined on page 1).

Ten years ago, funds targeting Emerging Markets and New Latin America were an exception; today, they are not. This development was anticipated and encouraged by IWC and we believe it will continue. There are however, still a significant number of opportunities in the more established markets.

What target returns are marketed?
The ranges of net real returns that managers believe they can deliver for each specific geography are presented in Figure 5. Note that it does not reflect actual performance but only the managers' expectations.

Dispersion of target returns within a region is due not only to different underlying assumptions used by the various managers, but also because of the specific assets targeted within the still heterogeneous geographies in terms of tree species and markets.

TIMBERLAND FUND TERMS

Fund life
Forest investments are by nature illiquid. With the exception of a few evergreen structures, timberland funds have finite life spans. The typical duration is 8 to 15 years with a possible 2 to 4 years extension period thereafter. Investors do have the option to sell their shares in a fund before liquidation; however, often at a discount. As far as IWC is aware, only a few secondary deals have been observed in the market over the last 20 years. As a consequence, the asset class is best suited for long-term, non-speculative investors.

Leverage
As shown in Figure 6, most timberland fund structures do allow for long term debt. However, from experience, only a small number which allow it, actually use leverage.

Management fees and expenses
Figure 7 illustrates the level of management fees after the commitment period asked by fund managers over the last 4 years. Note that it does not distinguish between the fee bases, which can have a major impact on total cost. The most common management fee basis among established managers is one based on the lower of capital invested and net asset value (NAV), whereas new players show a preference to charge based on NAV or committed capital.

Also, there is no industry consensus on what kind of expenses (e.g. property management or transaction fee) should be covered by the management fees and what costs are fund expenses.

The management fee level in funds that have successfully raised capital is significantly lower than those that have not (average of 1.2 % vs. 1.5 %).

Figure 5. Real net target IRR p.a. by target geography (number of funds)

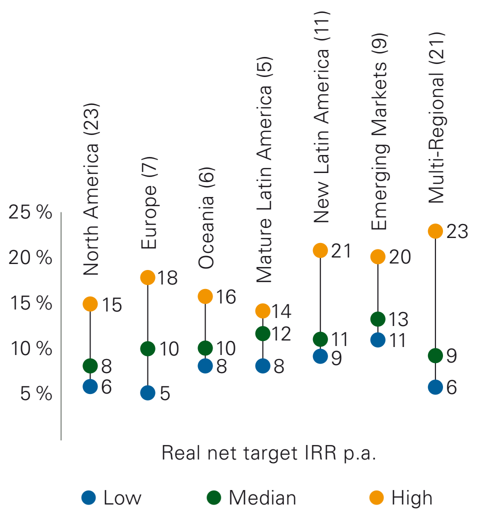


Figure 6. Level of maximum leverage in timberland funds (69 funds)

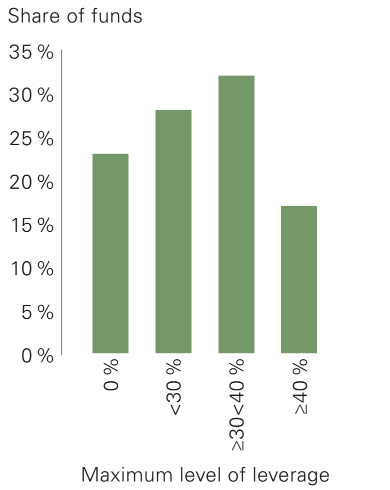
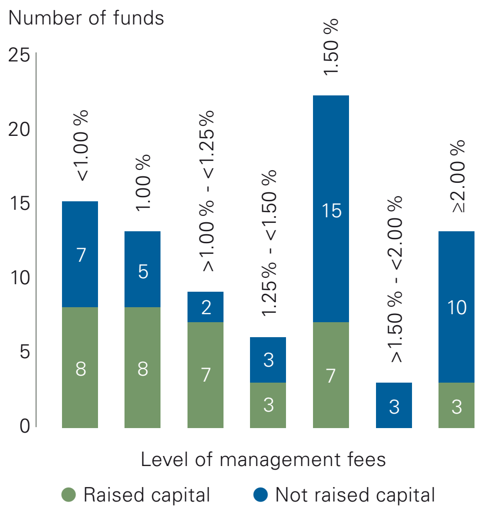


Figure 7. Number of funds by level of management fees after the commitment period



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Performance fees

With regards to incentive, the most prevalent format is a performance fee equal to a 20 % share of value generated above a predefined IRR hurdle rate, which varies according to target geographies and specific strategies.

The vast majority of funds have performance fees based on distributions only, making the need for claw-back provisions less relevant.

Catch-up is not frequently presented (22 % of the cases) and even less often used (12 % of the funds that have successfully raised capital).

HOW LARGE IS THE INVESTABLE UNIVERSE?

In recent years, forest investments have grown increasingly attractive to investors looking for asset diversification and competitive risk/return characteristics. Nevertheless, timberland is still a small asset class with approximately USD 50 billion invested by institutional investors nowadays, the majority of which is located in the United States.

According to the FAO, there are 3.95 billion hectares of forest in the world, of which, IWC estimates 165 million hectares to be privately investable, representing a value of USD 470 billion. In addition, investable public forestland via long-term lease agreements or harvesting rights is estimated to be 922 million hectares, representing a value of USD 250 billion. This would mean that only about 7 % of the total value of current available timberland has been invested in so far, leaving many opportunities for institutional investors to explore.

INFO

- IWC has developed a proprietary in-house database in which all timberland investment opportunities presented to IWC are monitored.
- During the past 4 years, IWC registered 88 timberland fund managers, among which, a growing number are regionally based.
- IWC knows of 109 timberland funds offered to institutional investors since January 2007.
- An increased number of strategies target the Southern hemisphere, especially Latin America.
- While ca. USD 50 billion is today invested by institutional investors in timberland, IWC estimates the total global timberland investable universe to be over USD 700 billion.

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