



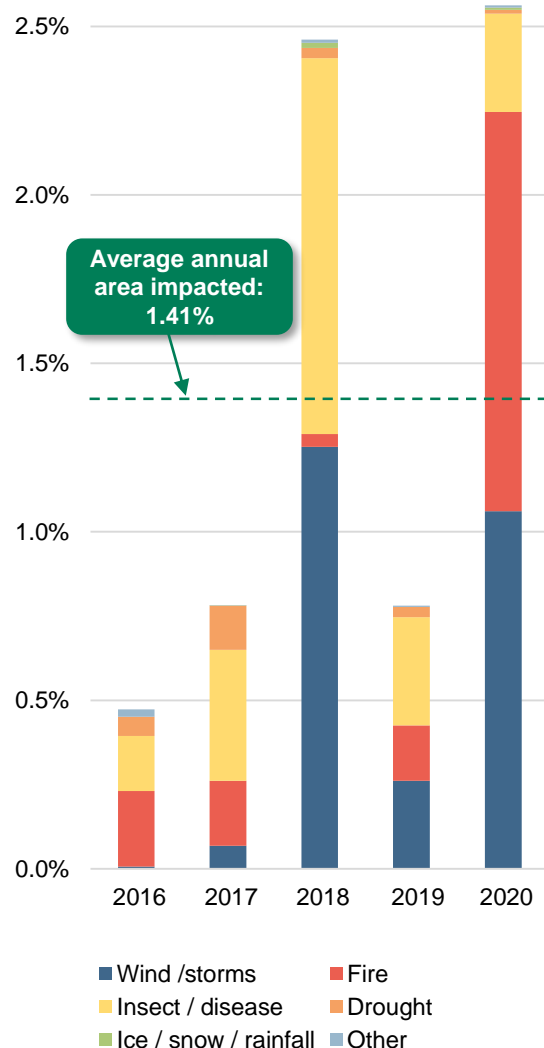
# **Timberland and physical risks**

## **2016-2020 actual impact**

**February 2021**

# Physical risks are real, but are the news headlines properly representing how significant they are for timberland owned by institutional investors?

## Percent of impacted area per year



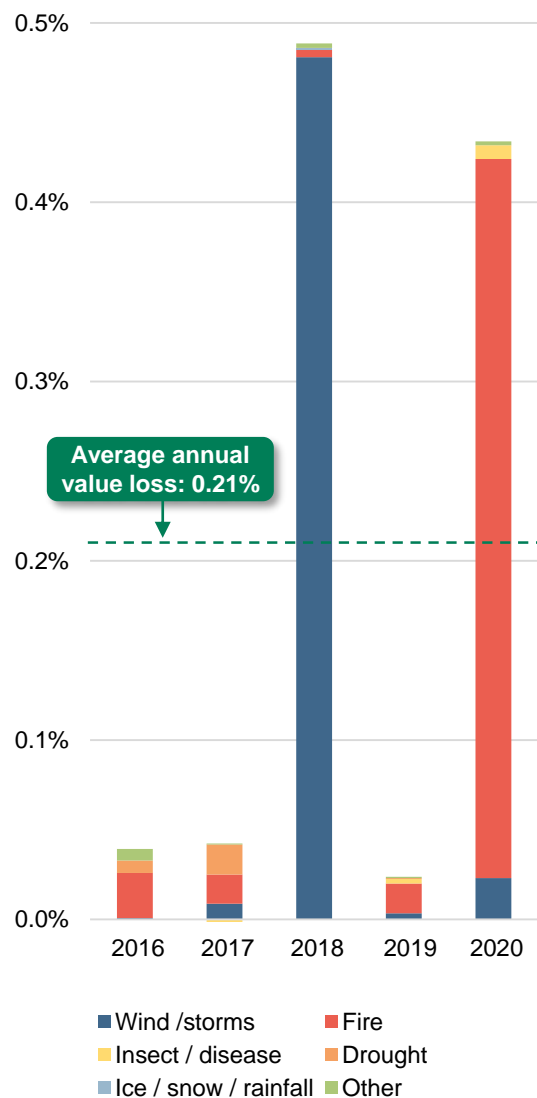
- Several larger natural events directly affecting forestland took place over the past few years, some of which were widely reported by news media, including:
  - Historic wildfires in Oregon, a series of hurricanes in the US South, and devastating bushfires in Australia in 2020
  - Hurricane Michael in the US South in 2018
  - The worst wildfires in Chile's history in 2017
  - An increase damage of a beetle infestation in Europe over the past few years.
- However, how much have physical risks impacted private timberland investors? IWC gathered data from underlying timberland managers with regards to all timberland properties IWC's clients had exposure to during the past five years (2016-2020).
- The resulting sample averaged an area of **2.4 million hectares of institutionally owned timberland** and a fair market value of **USD 14.8 billion** over the period.
- In value term, around 37% of the portfolio was located in the US South, 24% in the US Pacific Northwest, 17% in Oceania, and the remaining 22% was invested across Europe, Latin America, US Northeast, Asia, and Africa. We believe such portfolio to be a fair representation of the institutional timberland universe.
- IWC categorized physical risks, defined as both biotic and abiotic risks, into six groups:
  - Wind and storms
  - Fire
  - Drought
  - Insect and disease
  - Ice, snow, and rainfall
  - Other.
- Looking at the past five years, **0.47% to 2.56% of the portfolio's acreage has been affected by physical hazards, averaging 1.41% of the area annually.**
- The largest areas were impacted by wind / storms with on average 0.53% of acreage impacted, followed by insect / disease (0.46%), and fire (0.36%).

Although forests are inherently exposed to physical risks, actual damages on timberlands owned by institutional have on average been small, with 1.41% of area being impacted p.a. over the past 5 years

# How have physical risks recently affected institutionally held timberlands' performance?



## Percent of impacted value per year



- In terms of financial cost, timberland properties in IWC's clients' portfolios registered an **average annual loss of 0.21% of fair market value** during the 2016-2020 period, ranging from 0.04% to 0.49% on a single year basis.
- **Wind and storms events had the most impact with an annual average loss of 0.10% of asset value, closely followed by damages from fires resulting in 0.09% annual value loss.** All of the other risk categories saw insignificant value losses over the period.
- Losses are calculated net of post-event expenses (e.g. debris removal and reforestation, fire brigade charges, control of damaged property, harvested timber on decks and landings, etc.) and post income from salvage or insurance payables.
- The scale of financial loss is a function of:
  - The intensity of an event (e.g. ground fire vs. intense inferno, a category 3 vs. a category 5 hurricane)
  - The ability to salvage wood (access to the wood and contractors, spot price achievable)
  - Potential loss recuperation, should an asset be insured against such hazard.
- The discrepancy between actual impacts for institutional investors owning timberland and the public perception is mainly due to the news headlines often not distinguishing between public and private land, the latter benefiting from **active forest management** which:
  - Controls undergrowth, reducing the level of fuel in the forest
  - Structures forestland with fire breaks, in addition to having fire surveillance and prevention systems, as well as fire fighting capabilities (often organized cooperatively amongst private owners within a certain region)
  - Often includes the use of thinnings, reducing insect and disease outbreaks
  - Poses for quick action when physical events occur, including salvage operations to minimize financial impacts.
- **Insurance**, when financially viable, is also an important tool for professional timberland managers, as is **climate change scenarios integration** to one's due diligence and monitoring, including when valuing assets and modeling future performance, and possibly adapting investment strategies to materializing changes.
- Finally, **geographical diversification and preference for non-contiguous assets** is also key to limit catastrophic losses for one specific investor.

Actual losses pertaining to physical risks have on average been minor for institutional investors, with 0.21% of asset value p.a. over the past 5 years

Active forest management, portfolio diversification, insurance, and climate change integration are the main mitigation tools

International Woodland Company A/S

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