IPD UK Forestry index 2004

Forestry | index

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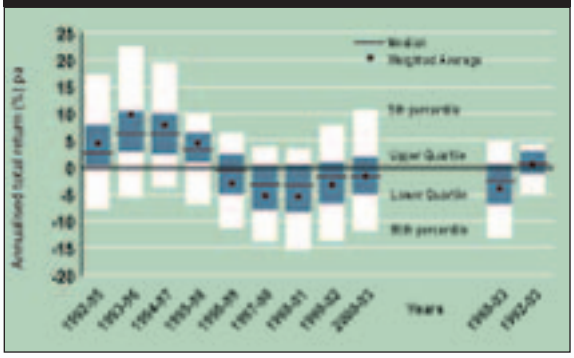
Long-term performance to December 2003

%pa	2003	3 years (2000-2003)	Annualised 5 years (1998-2003)	Long term (1992-2003)
Forestry				
Total return	**1.4**	-1.7	-3.9	0.6
Timber price change	**-2.8**	-10.5	-8.6	-8.1
Other assets				
Equities (Total return)	**20.9**	-6.8	-1.1	8.0
Gilts (Total return)	**1.8**	5.3	4.4	8.7
Commercial property (Total return)	**10.9**	9.1	10.5	11.5

Summary of results

A more detailed breakdown of the annual results, by region and age band, and including results on a smaller sample back to 1980, is available on the IPD website www.ipdindex.co.uk

Range of individual forest returns



Timber price index against IPD Forestry Index total returns

3 year rolling and long term annualised returns

	W'ted average	Top 5%	Upper quartile	Median	Lower quartile	Bottom 5%
3 year (%pa)						
1993-96	9.9	22.5	10.2	6.1	2.9	-5.6
1994-97	7.9	19.3	9.7	6.1	2.3	-3.7
1995-98	4.5	9.9	6.2	3.5	0.9	-6.9
1996-99	-3.0	6.4	2.2	-0.5	-5.0	-11.3
1997-00	-5.2	3.9	0.2	-3.1	-8.0	-13.8
1998-01	-5.4	3.5	0.3	-3.3	-8.4	-15.4
1999-02	-3.2	7.8	0.7	-1.8	-6.8	-13.7
2000-03	-1.7	10.7	1.7	-1.7	-5.0	-11.8

5 year rolling and long term annualised returns

	W'ted average	Top 5%	Upper quartile	Median	Lower quartile	Bottom 5%
5 year (%pa)						
1993-98	6.3	13.4	7.4	5.0	2.1	-3.8
1994-99	1.9	8.0	4.8	1.9	-0.4	-6.9
1995-00	-0.3	6.0	2.8	0.3	-2.4	-8.2
1996-01	-2.8	3.4	1.3	-1.0	-4.6	-10.5
1997-02	-4.4	3.3	0.1	-3.0	-6.9	-13.3
1998-03	-3.9	4.9	0.5	-2.6	-6.9	-13.1
Long term (%pa)						
1992-03	0.6	4.2	2.8	0.8	-1.3	-5.0

Summary

- The average total return on investments in forestry in 2003 was 1.4%. This marked an important upturn after five years of negative returns. The rolling three-year return for the period to December 2003 has improved to -1.7% a year and the long-term annualised return for the 11-year period since 1992 (the start of the Index) has risen to 0.6% a year.
- The range of individual forest returns in any period is wide, because plantation valuations move sporadically when market information and factors specific to the subject forest warrant a change. This reflects the fact that forestry is essentially a long-term investment. The range of individual returns narrows considerably when viewed over 11 years, but neverthless shows that the best forests have achieved returns above 4.2%, while the worst have returned below -5.0% a year.
- The -1.7% return on forestry investments over the last three years should be viewed in the perspective of returns to other asset classes. An investor in UK forestry would have received better returns from his forestry assets over the last three years than from the stock market. Although UK equity returns bounced back to 20.9% in 2003, equity returns for the last three and five years remain negative. Forestry returns also have a much lower volatility than either equities or gilts.
- Timber prices, which are the principal driver of plantation values and forestry investment returns, dropped by almost 70% between 1995 and early 2003. The Standing Timber sales price figures published by the Forestry Commission for the 12 months to March 2004, show a further slight drop over the year, but this hides an important turnaround in prices in the last 6 months, with Standing Timber prices rising by 7.5% between September 2003 and March 2004.
- Against this background plantation values have held up remarkably well. On the one hand, the timber element is diluted by the value of the underlying land; and on the other, the value of the standing timber is discounted back from the felling date by anything between 5 and 40 years. Although timber prices dominate plantation values, forestry valuations smooth the impact of timber market movements.
- The impact of weak timber prices is reflected most severely in the lower returns from plantations over 20 years old. These represent over 73% of the capital employed in the Index and are weighted accordingly in the overall Index results. The average returns on young plantations (less than 10 years old) have been 9.3% per annum over the last three years.

Tax status

Tax is a very important consideration for investors in forestry, but the wide variation of tax status between investors makes it impossible to reflect these benefits in the results. The Index excludes these substantial fiscal advantages that are available to the investor.

Income from timber sales in the UK is free of Income and Corporation Tax and growing timber is exempt from Capital Gains Tax. After two years of ownership, commercial woodlands also qualify for 100% Business Property Relief from Inheritance Tax.

The index

The IPD Forestry Index is calculated from a sample of private sector coniferous plantations of predominantly Sitka spruce in mainland Britain. By the end of 2003 the forests in the index had a total capital value of £69.3m.

The Index is derived from a series of annual valuations and cash flows, but in order to reflect the long-term nature of forestry investment the series is presented on a three-year annualised basis. The year-on-year returns and Index values are shown on the back of this publication, but analysis is now based principally on the annualised results. These demonstrate more clearly the long-term returns available to investors.

The series is based at 1992 after the expiry of tax relief on expenditure, which was withdrawn in March 1988 with a period of transitional relief until December 1992. The Index reflects movements in valuations driven by changes in the underlying long-term trend in UK timber markets and investor demand.

Market commentary
provided by the sponsors

After several years of weak performance the UK forestry market is at last showing some signs of recovery. Although commentators often focus on the multi-purpose value attached to forest properties, in practice the market for plantations is still driven almost entirely by timber prices, which are the predominant tangible cash generator. Some 85% of UK consumption uses imported products, so the market for home-grown wood is heavily dependent on the prices of imported wood products. However, the cause of the sustained weakness of UK log prices compared with those prevailing in other European countries is the subject of debate. Despite the upturn revealed in the most recent 6-month figures released by the Forestry Commission, UK timber prices remain out of line with those of other producing countries.

The relative strength of the pound and the availability of cheaper sawnwood from Eastern Europe have certainly been important, and the recent strengthening of the Euro and Krona has brought some relief. But there is a growing conviction that the underlying cause of weak UK timber prices is the current imbalance in the market for home grown logs; demand for sawnwood from top quality logs is firm, but other sawmill products (which together represent over 50% of the total log volume) are in over-supply. As a result log buyers have been discounting their offers to compensate for the low price of the sawmill co-products.

Recent success in re-establishing an export market for lowerquality logs and sawmill co-products to Scandinavia, where pulpmills continue to value virgin fibre from fast grown spruce, has provided an alternative market – albeit at unglamorous prices. One large UK forestry manager is expecting to increase its virgin fibre exports by 26% in the coming year.

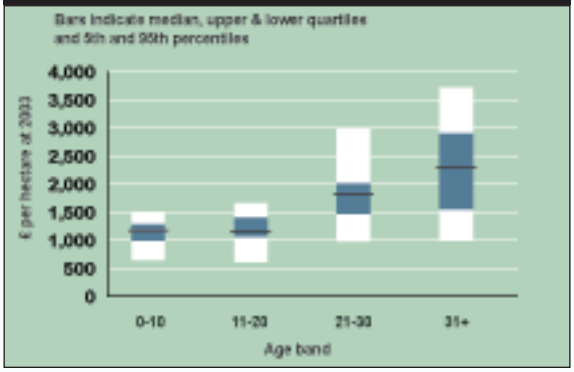
There has also been an encouraging increase in demand for energy-efficient timber framed housing. In 2003, a record 14% of all new homes were of timber construction, while in Scotland the proportion was 60%. Government penalties and incentives originating from the Kyoto Agreement to reduce CO_2 emissions and switch to energy from sustainable sources, are encouraging the electricity industry to develop generating plants using wood chips. All of these factors are helping to support domestic markets.

These developments have led to an improvement in prices for better quality sawlogs, and to some recovery in confidence and activity levels in the UK woodlands market. There has been a 5.5% increase in the total value of commercial softwood plantations sold in 2003 compared with the previous year, and at higher unit values. The motivation for some buyers has been Inheritance Tax (IHT) mitigation, for which commercial woodlands are a simple and effective method. The rapid rise in residential property values has led to a growing appreciation of the scale of IHT liabilities; this has been given substantial press coverage and has been accompanied by a government clampdown on a number of avoidance schemes, leaving forestry as one of the few legitimate methods to mitigate liability.

All-in-all there is justification for hoping that 2002 will prove to have been the nadir of forestry investment returns and that the upturn in timber prices in the six months to March 2004 marks the beginning of a recovery of both returns and activity levels. However, much will depend on the effect that rising UK interest rates may have on the strength of the pound relative to other key European currencies.

3 year annualised returns by age band

Range of valuations (£ per hectare) by age band at 2003



Performance by age and region of plantation

- Returns were positive on all age bands in 2003, and the youngest plantations recorded, for the third time in four years, average returns in double figures (10.5%). The 3-year annualised return on the youngest plantations has been 9.3% per annum, while the three older age bands have recorded returns between -1.6% and -2.7% over the last three years.
- Over the long term back to 1992, the youngest age band plantations have returned an average of 5.6% per annum, but total return on the oldest forests has been slightly negative (-0.7%). The 3-year rolling returns on mature forests hit a low point in 1997-2000, being hit by the collapse of timber prices in 1998, and they have been recovering slowly since then. Semi-mature forests, aged between 21 and 30 years, have seen the biggest oscillation in returns since 1992, peaking at 14.3% per annum in 1993-96 and recording the lowest returns (-7.2% pa) in 1998-2001.
- The range of performance within each age band is considerable as local conditions and timber quality can have a major effect on individual plantation valuations. Top quartile returns in the youngest age band over the last three years have been above 27.7%, and even the oldest forests have had the top 5% of returns above 11.2%, while the bottom quartile mature forests have recorded returns below -7.2%.
- The range of capital values within each age band is also wide. Median values vary from £1,183 per hectare for plantations under 10 years old, to £2,282 for mature plantations. Lot size, access, terrain, stem form, and amenity value, will all affect the valuations placed on individual estates. The top 5% of mature plantations are valued at over £3,715 per hectare and the top grade of semi-mature plantations have values in excess of £2,986, while lower quartile plantations in these bands are valued at less than £1,554 per hectare.
- Analysis of performance by region is obscured by differences in the age composition of the sample in each area, which is not perfectly balanced. Some of the variation in performance is undoubtedly due to this variation in age mix. Investment returns have been strongest on plantations in the Mid-Scotland region over the last three years, and weakest in Northern England and Wales; but over the long term, back to 1992, South Scotland has seen the strongest returns and North Scotland has lagged.
- The variation in returns over the last three years has been greatest in the North of Scotland, where the inter-quartile range is between 2.9% and -6.3%. But the distribution is most skewed in Mid Scotland. Here the weighted average (1.7%) is well above the median (-1.6%) due to the strong returns on a small number of the higher valued plantations in the sample.

Index series

Index series

Year end 31st Dec	Total return (%)	No. of forests	Total return index	Timber price change	*Timber price index
1994	9.8	126	104.9	21.1	134.8
1995	8.5	126	113.8	-5.6	127.2
1996	11.4	126	126.7	-7.5	117.7
1997	3.9	126	131.6	-14.9	100.1
1998	-1.4	153	129.7	-37.9	62.2
1999	-10.9	150	115.5	-2.7	60.5
2000	-3.0	152	112.1	-8.7	55.3
2001	-1.9	157	110.0	-4.9	52.6
2002	-4.6	164	104.9	-22.3	40.8
2003	1.4	162	106.4	-2.8	39.7

Total return and timber price indices based at 1992=100

** Forestry Commission Nominal Price Index of Coniferous Standing Sales (for Great Britain) on a year to March basis (2003 = March 2004). It reflects the price in other years of the size and mix of timber sold in the base year. This is based on a size and mix of timber in 1996 and the series has been re-scaled to 1992.*

Index design

The sample was originally structured to reflect market capitalisation across the regions and an approximately even number of plantations by age band in each region. This pattern has been distorted over the years by the ageing of plantations. For the purposes of the age band analysis plantations are artificially sold and re-purchased when they change bands. Properties are included in the three-year rolling returns according to their age in the end-year of the period. If a forest is sold from the sample it is replaced by one of the same region and age band. Felled plantations are replaced by the youngest age band whenever possible.

Tax position as at December 2003

INCOME TAX	All income from UK timber sales is free of Income & Corporation Tax
CAPITAL GAINS TAX	Growing timber is exempt from Capital Gains Tax
INHERITANCE TAX	After two years of ownership, commercial woodlands qualify for 100% Business Property Relief

Sample composition by age band

Years	0-10	11-20	21-30	>30	Total
No. of forests	12	47	40	63	162
% Capital employed	3.6	22.2	27.4	46.8	100.0

Sample composition by region

Region	North Scotland	Mid Scotland	South Scotland	North England	Wales	Total
No. of forests	21	28	58	21	34	162
% Capital employed	10.1	13.0	44.9	9.8	22.3	100.0

Valuation Range 2003 (£ per hectare)

Years	Top 5%	Upper Quartile	Median	Lower Quartile	Bottom 5%
0-10	1,505	1,285	1,183	986	651
11-20	1,666	1,386	1,147	1,056	610
21-30	2,986	2,009	1,811	1,485	971
31+	3,715	2,884	2,282	1,554	988

Acknowledgments
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Long term total return by age (%pa)

Year end 31st Dec Annualised	0-10	11-20	21-30	>30
1994-97	6.7	6.9	11.1	3.9
1995-98	4.0	4.2	7.0	0.5
1996-99	2.9	-0.5	-3.0	-5.4
1997-00	4.5	-2.3	-6.3	-6.4
1998-01	7.6	-2.8	-7.2	-5.1
1999-02	9.7	-1.5	-5.1	-2.6
2000-03	9.3	-1.6	-2.7	-1.7
1994-99	4.4	2.4	3.8	-1.4
1995-00	5.0	1.2	0.2	-2.6
1996-01	6.0	-0.4	-3.7	-3.8
1997-02	6.2	-2.5	-5.6	-5.1
1998-03	8.1	-2.2	-5.4	-3.9
1992-03	5.6	0.8	1.0	-0.7

Range of return by age 2000-2003 (%pa)

Percentile	0-10	11-20	21-30	>30
Top 5%	27.7	8.0	6.0	11.2
Upper quartile	19.7	2.4	-0.4	0.5
Median	10.8	-0.7	-2.7	-2.6
Lower quartile	1.1	-3.3	-5.0	-7.2
Bottom 5%	-2.8	-6.8	-14.0	-13.2
W'ted average	9.3	-1.6	-2.7	-1.7

Long term total return by region (%pa)

Year end 31st Dec Annualised	North Scotland	Mid Scotland	South Scotland	North England	Wales
1994-97	-5.7	1.4	12.0	7.8	9.0
1995-98	-4.3	0.1	6.9	5.3	5.2
1996-99	-5.7	-4.1	-3.6	0.5	-2.5
1997-00	-3.5	-4.3	-5.8	-5.4	-5.7
1998-01	-3.4	-4.1	-6.5	-5.8	-4.6
1999-02	-3.2	-0.3	-2.8	-4.5	-5.5
2000-03	-1.3	1.7	-1.9	-3.2	-3.1
1994-99	-5.1	-1.9	3.9	2.1	2.8
1995-00	-4.5	-2.3	0.5	0.4	0.5
1996-01	-4.0	-2.5	-3.3	-1.4	-2.9
1997-02	-3.6	-2.8	-4.5	-5.0	-5.6
1998-03	-2.7	-1.4	-4.5	-4.6	-4.3
1992-03	-3.1	-0.8	2.0	0.0	0.2

Range of return by region 2000-2003 (%pa)

Percentile	North Scotland	Mid Scotland	South Scotland	North England	Wales
Top 5%	18.2	12.6	7.5	7.3	7.4
Upper quartile	2.9	2.2	1.7	-0.9	1.3
Median	-1.4	-1.6	-1.1	-4.1	-2.6
Lower quartile	-6.3	-5.1	-3.6	-5.0	-6.9
Bottom 5%	-11.8	-7.8	-10.2	-9.2	-13.1
Weighted average	-1.3	1.7	-1.9	-3.2	-3.1

Contact:

Andrew Jennings MA, FICFor, Tel/Fax: +44 (0)1777 228 177

Richard Gwilliam +44 (0)20 7643 9239 richard.gwilliam@ipdindex.co.uk
Vida Godson +44 (0)20 7643 9300 vida.godson@ipdindex.co.uk

Investment Property Databank 7/8 Greenland Place London NW10AP, England
Tel: +44 (0)20 7482 5149 Fax: +44 (0)20 7267 0208 www.ipdindex.co.uk

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