



TIMBERLAND  
INVESTMENT RESOURCES LLP

★ ★ ★ ★ EUROPE ★ ★ ★ ★

# The Impact of the Coronavirus Pandemic on Timberland Investments

A Market Briefing with Chung-Hong Fu, Ph.D.



The pandemic outbreak of the novel coronavirus, COVID-19, has taken a significant human toll across the world. It also has upended the global economy and disrupted markets. The timberland investment sector is not immune from the pandemic's impacts. In this market brief, Chung-Hong Fu, TIR's Managing Director of Economic Research, offers a concise assessment of the ramifications of COVID-19 on the timberland asset class from a North American perspective.

## **Q: What pandemic-related impacts should timberland investors expect?**

**CHF:** As with most other economic sectors, the effects of the COVID-19 outbreak will be felt in the near term within the U.S. timberland investment market. Sawtimber prices will be most vulnerable as residential construction and repair and remodeling activities will be curtailed because of virus-related shutdowns. Despite this, demand for shipping boxes and tissue will sustain pulpwood demand, which will help mitigate some of the losses caused by the temporary weakening within the sawtimber segment. Looking ahead, the key economic fundamentals are supportive for timber. Demographic growth and rising income levels will drive wood demand long after the pandemic passes. The key for timberland investors is to have a long-term view and to be ready to strike and capitalize on opportunities that could emerge as a result of the market volatility that will be experienced.

## **Q: How will end-use market impacts influence timber prices?**

**CHF:** The most immediate challenge for timberland investors will be that a slowdown in wood use will cause timber prices to fall. Here, the picture is mixed. The market for pulpwood grade logs (smaller and lower-quality logs) should be healthy. On the other hand, the market for large logs, and specifically valuable, high-quality sawtimber, will experience contracting demand and lower prices. This is because sawtimber is used to produce lumber and other structural and framing building products and, as I just explained, the residential construction, remodeling and repair markets will fall in the short-term amid the coronavirus fallout.

## **Q: How is that likely to play out?**

**CHF:** Two-thirds of the lumber that is produced from sawtimber is used for new home construction and home improvement activities. Because of the pandemic, builders can be expected to face supply-chain disruptions and shortages of skilled labor. Furthermore, obtaining building permits and scheduling inspections will become increasingly challenging as municipal offices scale back services. Home builders also are likely to cut production as home sales drop off. In this regard, the National Association of Realtors recently projected that the coronavirus epidemic could cut home sales by 35 percent in the coming months. Likewise, home repair and remodeling activity will decline as many states and metropolitan areas curtail or advise against non-essential business activities.

## **Q: How do you quantify the impact of this?**

**CHF:** On a combined basis, this will cause lumber demand to retreat and prices to fall in 2020. Over the course of two weeks, the price of lumber, as tracked by Random Length's Structural Lumber Composite, has fallen 11 percent (through March 26) to \$381 per thousand board feet (mbf).



**Q: Why will the market for pulpwood remain healthy?**

CHF: While sawtimber markets will likely retrench in the face of lower lumber production, the situation is quite different for pulpwood. Pulpwood is needed to create the pulp that is used to manufacture packaging and tissue. Both of those products are in strong demand. Increasing use of e-commerce by home-bound consumers for example will increase the use of corrugated boxes. Paper products, such as bathroom tissue and paper towels, will experience sustained demand.

**Q: How well positioned is the wood products sector to weather the storm?**

CHF: Although there will be some rationalization of production, North America's mills are well positioned to keep running despite the effects of the coronavirus. The U.S. Department of Homeland Security has identified the wood products industry as an “essential critical infrastructure workforce.” This designation gives the industry immunity from government-mandated cessations of non-essential businesses, which are being implemented to combat the spread of the coronavirus.

**Q: Looking ahead, what is TIR's outlook for timber prices?**

CHF: Our view is that sawtimber prices will decline over the course of 2020 for the U.S. Pacific Northwest and the U.S. South. Should the impact of the coronavirus begin to fade in 2021, we could see a firm recovery in sawlog markets. Compared to sawtimber, pulpwood prices in some regional wood markets could see sustained gains over the next several quarters.

**Q: How is all of this likely to impact the performance of the timberland investment market?**

CHF: Clearly, the key question for timberland investors is how the coronavirus outbreak could impact the performance of their timberland portfolios. If history is a guide, the impact of the COVID-19 pandemic on timberland returns should be modest and short-lived. The National Council of Real Estate Investment Fiduciaries (NCREIF) has tracked the timberland asset class since 1987. Over the course of the 33-year history of the NCREIF Timberland Property Index, there were only two periods in which the index recorded negative year-over-year losses (see Table 1). Those periods were the Dot Com Crash of 2001 and the Great Financial Crisis of 2007-2009. During these eras, the Timberland Index's losses amounted to 6.5 percent and 5.7 percent, respectively – just fractions of the 49 percent and 56 percent declines experienced by the S&P 500 Index during those two U.S. recessions.

**Timberland Investment Losses in Past 30 Years  
Peak to Trough Loss in Value**

U.S. Recession	NCREIF Timberland	S&P 500
1990-1991	No Loss	-20%
2001 Dot Com Crash	-6.5%	-49%
2007-2009 Great Financial Crisis	-5.7%	-56%

This relative stability of timberland returns is due to the various and unique features of the asset class. First, a timberland portfolio is hedged through its diversity of products and species. Second, the biological growth of trees can help mitigate the opportunity cost of delaying harvest when timber is “stored on the stump” during weak markets. Third, and lastly, the wide diversity of ownership in forestland in the U.S. provides optionality and stability of value.



During the periods of market upheaval, like today, timberland could be favored by investors that seek hard assets with income-generating potential. In an ultra-low interest rate environment like the one we are currently experiencing, timberland offers the ability to generate cash while providing capital preservation.

**Q: How should this influence the behaviors of timberland investors?**

**CHF:** In this environment, investors should not shy away from committing capital to the timberland asset class. In fact, we see opportunities to capture value during the volatility that is resulting from the coronavirus pandemic. When seeking assets for our clients, TIR's underwriting assumes that timber markets will be in transition. Depending upon the local wood basket, we may discount sawtimber prices and reflect deferred harvests in the near term before seeing a recovery. Land sales in our pro forma will be delayed and adjusted accordingly. Aside from these considerations, we are utilizing the same underwriting process we employed before the coronavirus outbreak. Our discount rates and risk tolerance parameters have remained the same.

**Q: What's TIR's return outlook?**

**CHF:** Our position is that coronavirus' impact on wood markets will be sharp but short lived. The fundamentals that drive wood demand have not changed. Demographic growth drives demand for housing. Fannie Mae estimates that the pent-up demand for new homes has reached 2.5 million units after a decade of below-average rates of home construction. In addition, the average age of homes in the U.S. is 41 years old – a record high. An aging housing stock will drive demand for home improvement when employment and household incomes eventually recover.

**Q: How do you see this forecast influencing U.S. regional timber markets?**

**CHF:** Over the last five years, the **U.S. South** has experienced a dramatic (20 percent) expansion in sawmill capacity. More than half of U.S. housing starts are situated in the South, and this new lumber capacity is well placed to serve that demand. New mill capacity also has been added for oriented strandboard (OSB) and wood pellets. When the U.S. recovers from the coronavirus impact, these regional investments in mill infrastructure will create tight timber markets, which will produce benefits for timberland investors that hold assets in the region for the long term.

Last year was challenging for the **U.S. Pacific Northwest** because of a combination of the trade war with China and regional lumber prices. Demand should improve, however, because the neighboring Canadian province of British Columbia has seen one-fifth of its mill capacity shuttered. A secondary boost can come from China, which earlier this year signed a Phase One trade agreement with the U.S. In the agreement, China has pledged to accelerate purchases of U.S. agricultural products, which includes wood products. The Pacific Northwest stands to benefit from this because it is a major exporter of logs and lumber to the Pacific Rim.

In the **U.S. North**, timber markets are closely tied to the supply and demand for paper products and hardwood lumber. The printing and writing paper segments of the market, in particular, are in secular decline. Furthermore, the coronavirus outbreak and the slowdown in China has hurt hardwood demand. Exports of hardwood lumber to China will take time to improve, so we expect a couple of years of weak markets before a sustained recovery finally takes hold. Another future support for hardwood demand will be the home repair and remodeling sector, which should see gains in the medium-term.

**Q: How would you sum up everything you've just said?**

**CHF:** It is hard to know for sure how the coronavirus will ultimately impact the global economy and financial markets. We do believe that the development of vaccines and effective treatments will temper the global crisis and set the stage for a recovery. The same applies to timberland. Investors should expect a contraction of returns in the immediate term. Despite this short-term impact, the values of their timberland holdings should remain largely unaffected. While the market is in a state of disruption, there could be a window of opportunity to place capital in timberland assets that have the potential to generate strong values. I would just say that it is important to have a diversified portfolio and to focus on the long-term market fundamentals for timber.