# UPM Tilhill and Savills Forest Market Report

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In a year which has seen oil prices reach record levels, the economy slip towards recession and the nationalisation of three major banks, forest owners have bucked the trend seeing their investment continue the steady growth seen since 2000.

- Average plantation prices have more than doubled in the last five years, with headline growth at 52% since 2006.
- Like for like prices have increased 10-20% in 2008* compared to 2007.
- Five year capital growth on existing forests reaches 125-150%.
- Biomass will provide a ready market for forest products.
- Forestry Commission to sell woodland in 2009.

Forest area continues to expand in the UK and at 2.8 million hectares makes up some 12% of the land area. The UK's forests produce just 15-20% of the country's timber needs, but production is expected to rise by at least 50% over the next 15 to 20 years.

For investors in the current financial climate land and trees are seen as a safe haven, offering the added benefits of tax breaks, and a sustainable source of income as the biomass market continues its strong growth. A renewable resource with a land backed asset such as woodland has much to commend it.

### Taxation

Commercial woodland ownership enjoys a number of tax benefits:

**Inheritance Tax** – commercially managed woodlands receive 100% relief from inheritance tax.

**Income Tax** – income derived from the sale of timber harvested on a commercially managed forest is free from income tax.

**Capital Gains Tax** – increases in the value attributable to standing or felled timber is free from CGT.

This package of tax incentives is an important factor for many investors, especially those seeking to purchase older woodlands to generate additional income.

**In 2007 the report included two large portfolio transactions, accounting for almost 50% of last year's values. This has resulted in the distortion of comparative figures between 2007 and 2008. Where possible figures given relate to ongoing trends, i.e. a five year period.**



*the Forest Market Report captures data from 1 October to 31 September. The year referred to, ie 2008, is for the 12 months to 31 September 2008.

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## Market size and activity levels

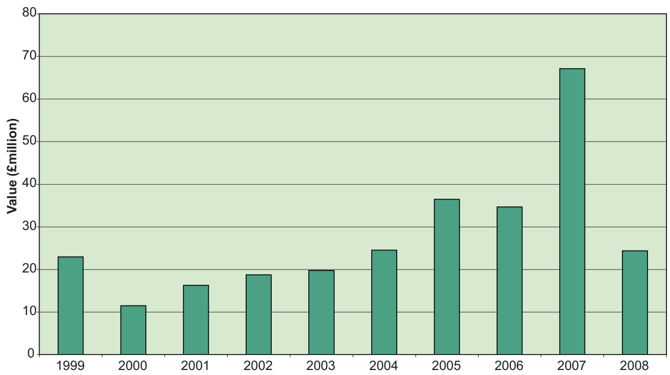
Forest transactions dropped in 2008 – just 50 compared with almost 88 in 2007 (***Fig. 1***). Sales of just 7,000ha represents less than 1% of the UK's privately owned conifer forests (the Forestry Commission own another 680,000 ha).

Reduced activity may be attributed to woodland owners, who have seen strong rises in value and optimistic forecasts, delaying selling up. However, this contradicts evidence over the last seven years which shows a link between rising prices and increased activity levels. The market appears reasonably buoyant and we expect activity to recover. Indeed the Forestry Commission has announced it will sell some woodland property in England and Scotland in 2009.

Total sales show an expected drop compared to 2007 (***Fig. 2***) because of the two large portfolio sales in that year. However, 2008 sales of £24.4m are down on the £34.6m of 2006. The average size of forest sold in 2008 was 135ha, a 10% increase on 2006.

**Figure 1:** *Annual total forest area sold, and number of forests sold*


**Figure 2:** *Annual value of forest area sold*

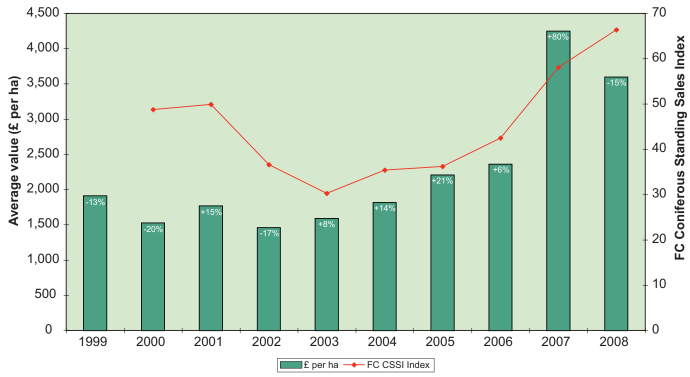



## Plantation prices and age band

Average plantation prices have risen by more than 100% over the last five years (***Fig. 3***). The average price per hectare was £3,596, continuing the long term trend of rising values for woodland.

Each year different properties are sold making direct comparison from year to year difficult, but the long term trend is clear – average prices have risen more than 100% since 2003. This increased value excludes the trees' biological growth. Investors also benefit from biological growth, some 5% per annum compound. An investor owning woodland over the last five years will be looking at capital growth of 125-150%.

**Figure 3:** *Average sale price and change in value, and FC Coniferous Standing Sales Index*



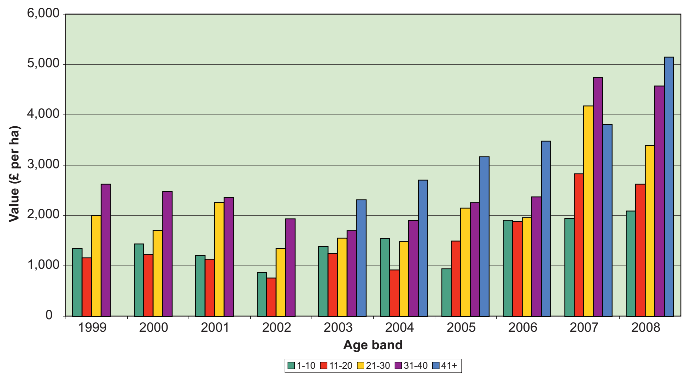

## Crop age and Yield Class

Both crop age and yield class (YC) are key components of value. In 2008 the average age was 27.0 years with average YC13.8, but in 2007 average age was 29.7 years at YC15.6. This equates to about an extra 50 tonnes of timber per hectare. With a current timber value of at least £15/T this represents some £700 per hectare – the difference between the average price per hectare for last year and this.

It is perhaps more relevant to compare 2008 with 2006 when both years' average YC was 13.8, but age in 2006 was 30.5 years. The average price per hectare rose 50% from 2006 to 2008, even though the 2006 crops were 3.5 years older. The extra years' growth could easily account for 40 tonnes of timber per hectare or some £600, suggesting the rise in like for like woods from 2006 to 2008 was some 70% or more.

Forest value by age band is shown in ***Fig. 4***. As the UK's forest resource matures, woods often contain a range of age classes; in these cases we use the weighted average age. In 2008 there is a clear correlation of values rising with age.

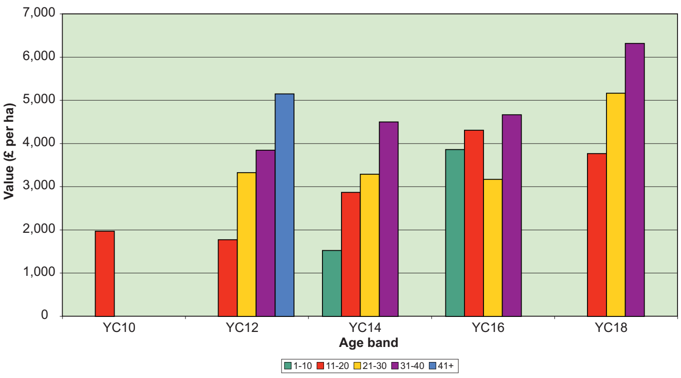
**Figure 4:** *Forest value by age band*




***Note:*** *For years 1998 to 2002 all woods over 30 years were put into a single category and are shown in the 31-40 year age class. Since 2002 they have been split.*

Yield class (YC) is the measurement of site productivity and crop growth rates. It is an important tool for appraisal – a higher YC equals greater productivity, and hence value. ***Fig. 5*** shows a good correlation of rising value with increasing YC. It also identifies a significant difference in value between YC bands for a given age, highlighting the importance of reliable crop assessment prior to valuation.

***Figure 5:*** *Forest value in 2008 by Yield Class*




## Timber market

The timber market in 2007 was generally strong, but 2008 has seen a marked slowdown, although this has not been matched by a fall in plantation values. In early 2008 the Forestry Commission's timber price indices for Coniferous Standing Sales and Softwood Sawlogs increased (***Fig. 3***) but in recent months the downturn in demand means lower prices for woodland owners.

The economic slowdown has seen reduced demand for roundwood across all sectors. Many sawmills and board processors have reduced capacity or are planning to take market related shuts. Increased production and energy costs are also reducing margins. On the positive side a weak pound is making imported timber expensive.

Demand for pulpwood exports to Scandinavia and Finland remains constant and planned Russian levy increases in 2009 mean this is unlikely to change.

Biomass is a growing market for woodland owners. In addition to existing woodfired plants at Shotton, Teesside and Lockerbie, further projects are now underway such as Tullis Russell in Fife and Drax in North Yorkshire. Biomass can generate real income by better utilising and marketing existing woody products.

For now it is difficult to see the timber market changing in the next 12 months. The timber market is cyclical and it is important to remember that major investment in both the sawmilling and biomass sectors will provide a ready market for forest products.

For detailed analysis see the UPM Tilhill Timber Bulletin download at www.upm-tilhill.com.

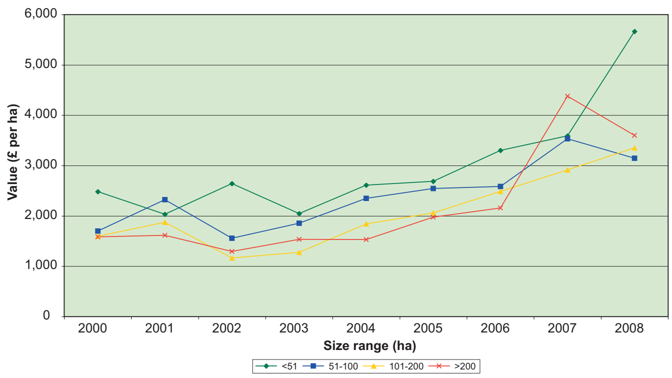
## Area/price relationship

The 2008 figures (see ***Fig. 6***) return to the long term trend of smaller woods having the highest value while woodland in the three larger categories show broadly similar values.

The 10 woodlands sold in the smallest category had an average value of £200,000, up 57% from last year. Many of these woodlands, established with commercial objectives, are now being bought by individuals looking for a combination of factors, including amenity, sport, and development hope value.

Demand for small woods remains intense with prices highest close to centres of population and for properties of high amenity. Sales in the south of England often reach the £8-12,000/ha range. Prices of £2-5,000/ha are typical for more remote properties, or where amenity values are lower.

***Figure 6:*** *Forest value per hectare, by size range*



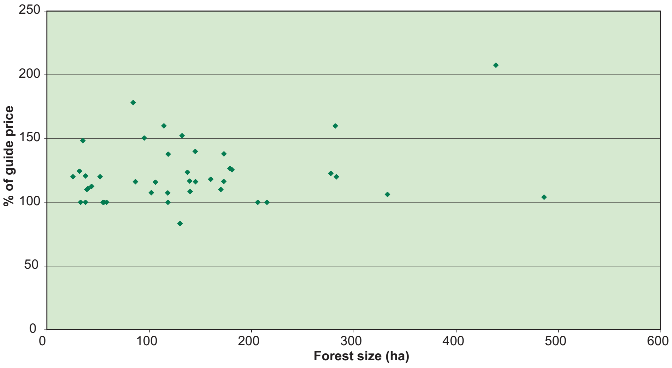
## Sale price/guide price relationship

*Fig. 7* shows the variance of prices paid against the agent's guide. The average sale price was 22% above guide, down on last year but still an indicator of a strong market. Just one sale failed to achieve guide and a significant 16% sold for more than 40% over the guide. Selling agents usually set a guide with an expectation of achieving a premium, but an average premium of 22% suggests the level of offers has taken agents by surprise.

Transaction time, from marketing to completion, averaged four months in 2008 although this does include a number of private deals which tend to be quicker. The patterns are consistent across the size classes.

These are all characteristics of a strong rising market. Most transactions involve professional agents acting for buyers and sellers, yet there is still a wide range of prices achieved against the guide. This suggests that buyers who don't take professional advice and are heavily influenced by the guide may badly misread the market.

***Figure 7:*** *Sale price as a % of guide price by forest size*




## Purchaser profiles

Capital growth, together with Inheritance Tax mitigation, remains the primary reasons for woodland purchase. Most buyers are from the UK, with the balance mainly from other European countries.

## The future

In last year's commentary we flagged up a few warning signs including falling timber prices, economic slow down and the impact of the credit crunch; suggesting 2008 might be a time for the market to pause for breath. In reality the negative factors have been much more severe. Yet average woodland values have risen, perhaps because of rather than in spite of the economic woes.

Anecdotally higher prices were paid at the beginning of the 2008 period and it was suggested that with the market so buoyant in 2007 many owners were more likely to hold rather than sell. A shortage of property on the market may reflect this sentiment and have helped push up prices.

However, the latter half of 2008 has seen more woodland on the market. This will test the levels of demand into 2009. After many years on the sidelines Forestry Commission is bringing woodland to the market in both England and Scotland.

Land and trees are seen as a safe haven in these uncertain economic times. Agricultural land has increased in value substantially in the first nine months of 2008 including a 15% rise in Scotland. However, forest investment won't escape the downturn in construction and associated falls in timber price. If this is anything other than a fairly short term blip the value of mature woods with immediate fellings will fall, but the picture for younger woods remains optimistic.

In the long term there are many positive features for the forestry market. India and China will continue to grow and consume wood from around the world. Oil prices are likely to remain high adding further economic justification to using wood as a source of energy, in addition to any carbon benefits. There remains an air of optimism about land ownership and timber as a commodity. No sudden change in the forest market is expected, with the possible exception of mature woodlands. Clearly 2009 is going to be a much more challenging environment than recent years.

## Woodland diversification

Increasingly woodland diversification is a motivating factor for woodland purchasers. Opportunities exist to diversify into non-traditional activities such as wind farms, leisure activities and tourist development. Woodlands often occupy hill top sites that are ideal for wind farms and telecommunication masts. With turbines producing as much as £10,000 annual rent they have proved to be a real bonus for a lucky few. UK Government targets for renewable energy generation will inevitably lead to more wind farms and further opportunities for woodland owners.

Leisure development in commercial woodland includes mountain bike tracks and paint balling, both of which can enhance freehold values. Tourist development is possible in a small number of locations, but can add significant value. Approval for residential development is often very difficult, but with plot values in excess of £100,000 in many parts of the country even one plot can transform the value of a woodland block.

Many woodland owners take a long-term view, and there is no rush to sell. Though it is expected to be a cautious market in 2009 good buying opportunities will exist, but careful evaluation is required before making a purchase.

## Data collection

The Forest Market Report records some 900 transactions from October 1997 to September 2008. All exceed 25 hectares and have 50% or more coniferous content. Data includes crop ages and yield classes for the primary productive species.

This report includes publicly-recorded sales and, where possible off-market sales. Off-market sales are difficult to quantify and could add 25% to the market.

The area referred to is the nett area that is carrying a crop. Unplanted land or ground for replanting is excluded. The transaction date used is that on which the legal liability transfers, i.e. exchange of contracts or date of entry.

## Market background

Most of the forests being traded were planted between the 1960s and the late 1980s and the predominant species is Sitka spruce.

Timber values have risen substantially in recent years. Investors are also appreciating the green credentials of forestry, for example as a source of sustainable bio-energy and a place to sequester carbon.

This research is a snapshot of the commercial forestry market. Woods sold in 2008 are different from those sold in 2007, and previous years, therefore, while the results show useful trends, readers should not base investment decisions on these comparisons alone.

**For more information please contact:**


UPM Tilhill

**Simon Hart** (for central and northern Scotland)
Woodland Investment Adviser
Tel: 01786 435000
Email: simon.hart@upm-kymmene.com

**Jason Sinden** (for southern Scotland)
Woodland Investment Adviser
Tel: 01387 711211
Email: jason.sinden@upm-kymmene.com

**Guy Warren** (for northern England and Wales)
Woodland Investment Adviser
Tel: 01524 272249
Email: guy.warren@upm-kymmene.com

**Crispin Golding** (for midlands and south England)
Woodland Investment Adviser
Tel: 01844 279911
Email: crispin.golding@upm-kymmene.com

**www.upm-tilhill.com**

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**Ewan Berkeley**
Investment & Valuation
Tel: 01356 628 605
Email: eberkeley@savills.com

**Anna Thomas**
Purchases and Sales
Tel: 0131 247 3704
Email: athomas@savills.com

**Ali Gemmell**
Investment & Valuation
Tel: 01738 477 512
Email: agemmell@savills.com

**www.savills.co.uk/rural**


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