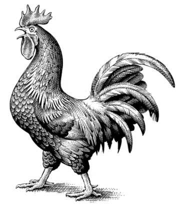
Chanticleer

Forests turn a new leaf to emerge as a growth asset

Institutional investors are increasingly tipping money into timberland assets, either through pine plantations or environmental planting.



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When former IFM Investors [https://www.afr.com/street-talk/ifm-investors-ndis-biz-my-plan-manager-cements-no-1-spot-with-bolt-on-20221018-p5bqre] chief executive, Brett Himbury, joined Stafford Capital Partners as chairman last year, he did the equivalent of a mini-MBA in one of the few assets in the world not correlated with movements in equities: forestry [https://www.afr.com/companies/financial-services/sydney-forestry-fund-eyes-trillion-dollar-opportunity-20220519-p5amtf].

Stafford, which was founded in Australia 22 years ago by Richard Bowley, Geoff Norman and Stephen White, has been a pioneer in timberland investment. It now has $US2.9 billion ($4.5 billion) of its total $US7.9 billion infrastructure portfolio in forestry.

Stafford Capital Partners chairman Brett Himbury can see the forest beyond the trees. **David Rowe**

Stafford has generated a 12.7 per cent per annum gross return since inception across its secondary and co-investment programs, across 86 timberland investments.

The portfolio covers 4.7 million hectares of forest plantations in North America, Latin America, Australia and New Zealand. It is actively managed with 54 investments sold at internal rate of return of 9.2 per cent a year since inception.

"Forests have the potential to play a greater role in institutional portfolios given the demand for unlisted assets, the positive macroeconomic thematics underpinning timber supply and demand, and the additional economic and environmental benefits in a net-zero world," Himbury says.
He says there is an intense international debate about the biodiversity aspects of pine plantations versus natural forests. Stafford argues that plantation forests play a vital role in reducing pressure on natural forests to meet growing wood demand.

Research undertaken by Stafford found that planted forests make up only 7 per cent of the world's forest area, yet supply more than 50 per cent of the world's demand for industrial wood.

Supply and demand

"Most plantation forests are established on degraded agricultural land with limited biodiversity value," Himbury says.

"Research shows that plantations established on such land make a substantial positive impact on biodiversity."

In Australia, the demand for timber in use in housing, construction and packaging will create a demand-supply gap over the next 30 years equivalent to 6.5 million cubic metres (m3) of softwood timber each year, according to a report on industry dynamics published by Forest & Wood Products Australia.

The report says that by 2050 Australia will have a population between 33.62 and 39.97 million people. But the amount of sawmilling capacity is expected to remain static at about 3.6 to 3.8 million m3 a year.

This will force Australia to rely on imports, which would need to triple to make up the gap between supply and demand. Reliance on offshore markets for essential materials is a dangerous strategy as shown by the fallout from the Russian invasion of Ukraine.

Forest & Wood Products Australia says we could mitigate the risks of failing to meet the gap in supply through immediate action to establish as much as 468,000 hectares of additional softwood plantations, commencing immediately.

Strong market fundamentals

Another big Australian-based investor in timberland is the Future Fund, which has $1.5 billion in forestry assets held through a mandate Campbell Global, which has invested in plantations operated by OneFortyOne.

OneFortyOne was formed in 2012 following the acquisition of a 105-year lease of 80,000 hectares of plantation assets from the South Australian Government. It later expanded into New Zealand.

The major attractions of forestry as an investment class are the strong market fundamentals, the stable cash yield, portfolio diversification, a hedge against inflation and quantifiable climate benefits.

Timber has outperformed most traditional asset classes since 1992, according to a report published last year by Nuveen Natural Capital.

It found that in the 28 years to 2020, timberland had a mean return of 9.26 per cent a year, compared to 5.81 per cent for US fixed income, 5.49 per cent for non-US fixed income, 11.16 per cent for US equities and 7.5 per cent for non-US equities.

Although US equities performed better, they had a standard deviation – which is a measure of volatility – almost double the rate of timber.

The most widely used index for measuring timberland's performance over time is the NCREIF Timberland Index, which has low or negative correlations with traditional asset classes and positive correlation with inflation.

However, there are risks associated with investment in plantation forests, according to an industry expert who spoke to Chanticleer.

He says plantation trees may be from a limited genetic base and these days the big companies use tissue culture, so the trees are actually genetically identical.

This means that if a disease, insect or pathogen arrives then the trees that are sensitive to the plantation may be decimated.

There are also the risks of fire, wind and storm damage and hot or cold weather. The expert says that these risks are not frequent, but plantations and forests are long-term production processes so over the life of a tree even a low risk might be realised.

He says that if an event happens then the damage and loss includes the growth from establishment to the time of the event. The re-establishment costs (removing the damaged trees and replanting) less any income from salvaging any useful timber can be high. There are also the flow-on effects of interruption to supply, immediately or later on.

For example, the 30,000 hectares of pine plantation burned south of Tumut in 2019-2020 would have punched a hole in the timber supply to the industry locally but also in the state and for the country.

At $4000 per hectare for establishment (not including clearing the burnt forest) replanting costs are high.

Also, the expert says because wood is a global commodity and the price tends to be set around the trading prices for plantation wood, the price that can be charged for wood from natural forests is “capped”.

This means that the cost of management for natural forests, which are much more complex and provide multiple benefits (both passive and active) is also “capped”, he says.

Adding complexity to the pricing issue is the question of transfer pricing and the supply of wood on the international market being influenced by illegal logging.

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