

MARKET SNAPSHOT
FOREST PRODUCTS



Dec. 31, 2018

Executive Summary

Drivers for the forest products industry include slow but steady housing starts and stabilizing log and lumber prices after recent declines.

- Seasonally adjusted U.S. housing starts are slowly climbing but remain below historical averages.
- Pacific Northwest log prices fell from midyear highs as mill inventories increased; prices continue to decline but at a slower rate and are expected to be reaching a floor.
- Lumber prices experienced a brisk decline but are expected to maintain levels similar to 2017.

12-Month Profitability Outlook



Northwest FCS' 12-month outlook calls for profitable margins for both timberland owners and sawmill operators. Despite a recent drop in log prices, timberland owners continue to generate profits. Lumber prices remain profitable, though down from elevated levels this past summer.

Small Woodland Spotlight

Small-woodland owners struggled to secure logging contracts with elevated log prices as contractors were booked with work. Given lower log prices, small-woodland owners may have an opportunity to secure logging contracts.

With softened prices, logging companies may be scaling back on purchasing standing timber, instead focusing on contract logging due to uncertainty in short- to medium-range log prices. However, care must be taken to ensure mills will accept logs at desired prices, since mills are near inventory capacity levels.

Starting 15 to 20 years ago, timber investment management organizations (TIMOs) began acquiring timberland as a tool to diversify portfolios and drive returns to investors. Over the years, TIMOs changed the landscape of forestland ownership. However, recent rises in interest rates, disruptive tariffs and trade policies have pressured returns to these investment organizations. As a result of pressured returns to TIMOs, some small-woodland owners have submitted successful, unsolicited bids to acquire additional land.

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Timber Investment Indices Relative to Other Assets

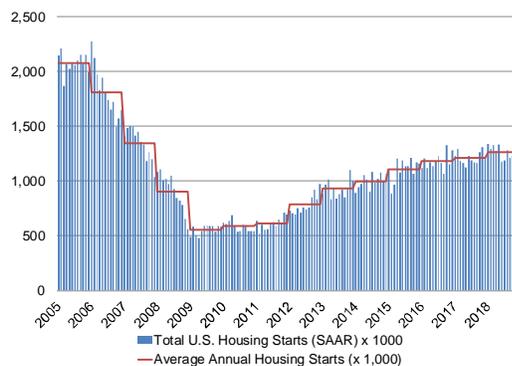
Date	S&P 500	NAREIT All REIT Index	NCREIF Timberland Index	Forisk Timber REIT (FTR) Index
2013	26.9%	-1.2%	9.7%	6.2%
2014	11.4%	21.9%	10.5%	5.7%
2015	-0.7%	-2.0%	5.0%	-9.3%
2016	9.5%	5.0%	2.6%	5.0%
2017	19.4%	4.8%	3.6%	18.1%
YTD 2018	-0.6%	-5.1%	1.4%	-22.8%

Source: Forisk, "Halloween Hangover: Timber REIT Returns and Timberland Markets." Nov. 1, 2018.

Housing Starts

Total housing starts remain relatively weak compared to the long-term average. Although housing starts climbed slightly in the third quarter, yearly gains have been weak for the last two to three years. Gains from year to year are nearly flat recently, below the historical average of around 1.5 million units on a seasonally adjusted annual rate (SAAR). This may be a signal that the housing market is at its peak or establishing new normal growth levels.

U.S. Housing Starts

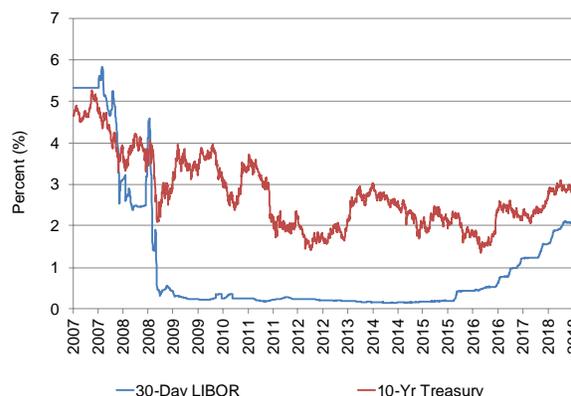


Source: U.S. Census Bureau

Interest rates

Interest rates are climbing gradually, with long-term rates rising approximately 1 percent over the last year and short-term rates rising approximately 1.25 percent.

Daily Interest Rates



Source: NWFCs Treasury Department

While these rates remain historically low, they may be influencing housing starts and home inventory for sale. In the past, when short-term rates rise above long-term rates, referred to as an inverted yield curve, a recession soon follows. For now, short- and long-term rates are maintaining their spread.

Log Market

Inventory levels at most mills are elevated heading into 2019. Prices have come off their midyear highs but remain profitable.

As inventories have filled, log prices lowered. The largest decreases are seen in southern Oregon, which experienced the highest prices during the summer months. Now southern Oregon has the lowest prices in the region, reflecting a 26 percent drop in prices from their 2018 highs. However, even with that drop, prices are within historical normal ranges. Forest Economic Advisors (FEA) projects 2019 log prices slightly lower than they were in 2018, but FEA expects a cyclical peak in 2021 and foresees prices bouncing back.

Douglas fir #2 sawmill prices, \$/MBF



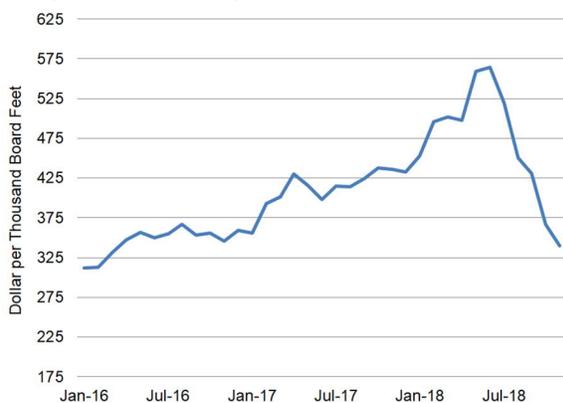
Source: Random Lengths.

Ongoing trade negotiations with China are affecting both softwood and hardwood markets. Recent events indicate relief in the tensions between China and the U.S., but nothing concrete has been agreed upon.

Lumber Market

Lumber prices are coming off multi-year highs. October's Random Lengths Framing monthly average is \$367 per thousand board-feet, which is well below the all-time high of \$564 per thousand reached this June. Despite softening, lumber prices remain profitable.

Composite lumber price



Source: Random Lengths.

Forest Economic Advisors forecasts 2019 lumber prices closer to 2017 levels as demand stays solid. Residential improvements and single-family construction are the biggest users of lumber. Consumption

of softwood in both of these end markets has been increasing since the Great Recession.

Additional Information

Northwest FCS Business Management Center
www.northwestfcs.com/Resources/Industry-Insights

Forest Economic Advisors (FEA)
www.getfea.com

Random Lengths
www.randomlengths.com

RISI Log Lines
www.risiinfo.com

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