

Oxygen Investments Limited

Hardwood Investing – Money really can grow on trees....

Investing in timber, in particular - Hardwood is not a new idea; in fact, according to the National Council of Real Estate Investment Fiduciaries (NCREIF) timber investments have outperformed the S&P 500 since 1987.

Smart Money Magazine recently stated “The track record of early investors and a slew of recent academic research - indicate that timber is a near perfect asset.”

US fund manager Jeremy Grantham thinks timber is the best long-term investment there is, and last year the Harvard Endowment Fund invested \$500m in forestry in New Zealand, says Barry Riley in the FT.

So what’s so good about trees? According to Grantham, forestry is the only low-risk, high-return asset there is: it has, he says, risen steadily in price for 200 years and has returned an average of 6.5% a year for the last century. It is also counter cyclical – it has been the only asset class in existence that has risen in three out of the four market collapses of the 20th century, says Grantham.

So, what is hardwood investing all about? Well, it ‘s a commodity that you can own that has an inherent advantage over many others. Timber can increase both in value (the board foot price) and quantity (the number of board foot). As an example - Suppose you were to buy a bar of gold that in 10 years had increased in value, yes you would have seen a return, but you will still only own 1 bar of gold. With timber, you can see not only an increase in value, but an increase in the quantity – timber grows.

Institutional investors now own approximately \$22 billion in timberland, according to The National Real Estate Investor

Why Invest in Hardwood?

Because the tropics make up a very narrow band of the world, there is a very limited supply of tropical hardwoods, which are in high demand. As we know, if the demand is high and the supply is low, it means you make money, whilst helping to protect the environment.

Demand - World consumption of tropical hardwoods has multiplied nearly 25 times in just the last four decades, to more than 100 billion board feet of tropical hardwoods now being consumed each year. Take China. On current forecasts, its urban population will increase from 530 million people to 875 million people by 2030. To house them, the equivalent of almost 50 cities the size of greater London will have to be built over the next 20 years. That’s going to need a lot of timber. And wood is needed for every stage of development all over Asia.

Supply - At the same time, the world's supplies of tropical rainforests are being destroyed at the rate of 30 to 50 million acres each year, and along with them, the world's supply of tropical hardwoods. At this rate there will be very little left in 30 years. As a result, prices of tropical hardwoods continue to escalate.

Every second a piece of rainforest the size of a football pitch is lost forever. The Food and Agriculture Organization (FAO) estimates that each year about 13 million hectares of the world's forests are lost due to deforestation. From 2000 to 2005, the net forest loss was 125 square miles per day.

The world has a limited supply of both land and timber, and global demand for timber is increasing as the global population increases. The long-term global market is solid; the U.S. may encounter short-term housing market downturns, but China, India and other booming populations show no sign of slowing in demand.

Timber prices are not correlated with stock market trends, even though some timber companies are publicly traded on the market. Timber tends to do well during stock downturn periods when investors shift from riskier stocks to safer investments.

Large institutional investors like pension schemes; unit trusts etc have been including this investment strategy in their portfolios for many years.

How Does the investment work?

Timber investments usually start with seedlings that are planted and nurtured until they grow into mature teak trees that are then harvested for profit. As the trees grow they need 'thinning', which is the process of harvesting some of the trees to allow the stronger ones to grow. This harvesting process normally happens every 4-5 years, but is dependent on growing conditions and company policies. Once the trees are harvested they are sold on the open market.

There are several different ways in which you can get involved in timber investing.

1. Buy Shares in publicly traded companies.
 - Easy exit strategy.
 - Normally offers the lowest returns.
 - No control over the harvesting schedules.

2. Timber Management Investment Companies - privately-held organizations that manage timberland with the intention of producing the greatest long-term returns possible with minimal risk.
 - Complete control offered by some companies.
 - Modest capital required.
 - No specific plantation skills required.

3. Purchase the land directly then plant and manage the forests.
 - Greatest degree of control.
 - Specific knowledge of managing plantations needed.
 - Large investment capital needed.

How long you retain this investment is entirely up to you.

What are the returns?

This is where the good news comes in. Hardwood investing should be considered a medium to long term investment. If you were to invest with a timber management company you are unlikely to see any returns for the first 5-6 years, however, after that there is generally a thinning every 4 years and therefore a return to you every 4 years. You should expect to pay a one off lump sum for the trees, with no further up front costs of approx £9,000 to £11,000 for 200 trees with a return in the region of £120,000 over 25 years. The returns get higher as the trees get older due to the increase in the price of the timber.

The environmental approach.

It isn't everyone who can (or wants to) live in a rainforest. But a forestry management company can take care of your trees for you. There are several forestry management companies around – some good, some not so good. The best ones act with the environment fully in mind, by returning the land back to permanent forestry. Others may choose to sell the land to developers in the future – not exactly the green approach you might expect!

You can tap into the market pressures that are destroying the rainforests and actually help bring them back. There is a strong demand for tropical hardwood, and it keeps growing. Wouldn't it be great if the very forces that are threatening the rainforest with extinction were used to cause it to increase instead of decrease! Rather than put all of your investment dollars into stocks and bonds, how about investing some in trees? At least with trees, you know they're always going up! You will not only be getting a good return on your money, but you'll know you're helping bring about the return of the rainforest.

If you live an average lifestyle in the USA, the amount of carbon dioxide you produce per year is 40,000 pounds, according to the EPA. This is an accumulation of all the activities in your life, not just breathing. The bulk of it is from using fossil fuels to generate electricity and run your car. The US "ant colony" of 5% of the world's population is responsible for 25% of the carbon dioxide released in the world. Carbon dioxide has to be tied back up (sequestered) somehow, and we've already reached the point where the shrinking forests can't do the job. Yet in 1990, 100 acres per minute of forest were being cut down, and by 2004 that figure rose to 149 acres per minute.

You may never have cut down a tree, so you may feel that you haven't contributed to deforestation. How much harm could you personally have caused by your use of nonrenewable wood products and the amount of carbon you send out into the atmosphere? Not that much, really. But multiply yourself by billions, and the forests cannot keep up. The harsh reality is that

they are not keeping up.

In spite of what we've done, no matter how much noise we make about it, we are not slowing down deforestation. It keeps escalating.

Costa Rica.

When looking at Hardwood plantations (Teak), there is only a narrow band around the equator where hardwoods are grown. Choosing the best country for your investment is not an easy one. Political, economic and tax regimes are different in every country, but Costa Rica is one country that stands out from the rest.

Costa Rica has a stable democratic government, that actively encourages investments in forestry by passing special laws to protect investors. (Forestry Law #7575.)

The World Bank has given Costa Rica an excellent bill of overall political and economic health. At its annual conference in El Salvador, the bank lauded the country as possessing "one of the most stable and robust" democracies.

With seaports on both the Atlantic and Pacific coasts, Costa Rica has good shipping access to the markets of Europe, Japan, as well as North America.

Costa Rica has had a stable democracy for more than 100 years, and its constitution and laws guarantee private property rights for both Costa Ricans and non-Costa Ricans alike. Costa Rica also has a prospering economy with modern services.

What to look for when choosing a timber Investment management company.

Here is a short list of things you should be aware of.

- The soil and the climate make a huge difference. The quality of the land is incredibly important when you are GROWING things.
- The quality of the maintenance is critical. If you plant teak and do nothing, you are liable to have nothing. The trees will grow, but the market for teak is for clear, straight logs. This requires planning, weeding, and pruning, especially for the first 3 years.
- Does the company know how to sell your lumber? If they sell your trees as stumps, they will have to know what it is worth and if the logger is to be trusted.
- Anyone can sell and make money on full-grown, valuable tropical hardwoods; the challenge in the numbers usually seen is in selling the thinnings. The wood of the thinnings is valuable, but you have to work at reaping that value.

All investments are subject to the problem of frauds and scams, and tree plantations are no different. You have to do your own due diligence, research and evaluation to determine if you wish to invest in any reforestation project

Protection – You should, at the very least make sure you get title to your trees, and a lease on the land upon which the trees are planted.

Control – Ultimately, you want to be in control of your asset. The more control you have the greater the options are for exercising your rights.

In the time it took you to read this article, the world lost about 1,500 acres of trees.

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