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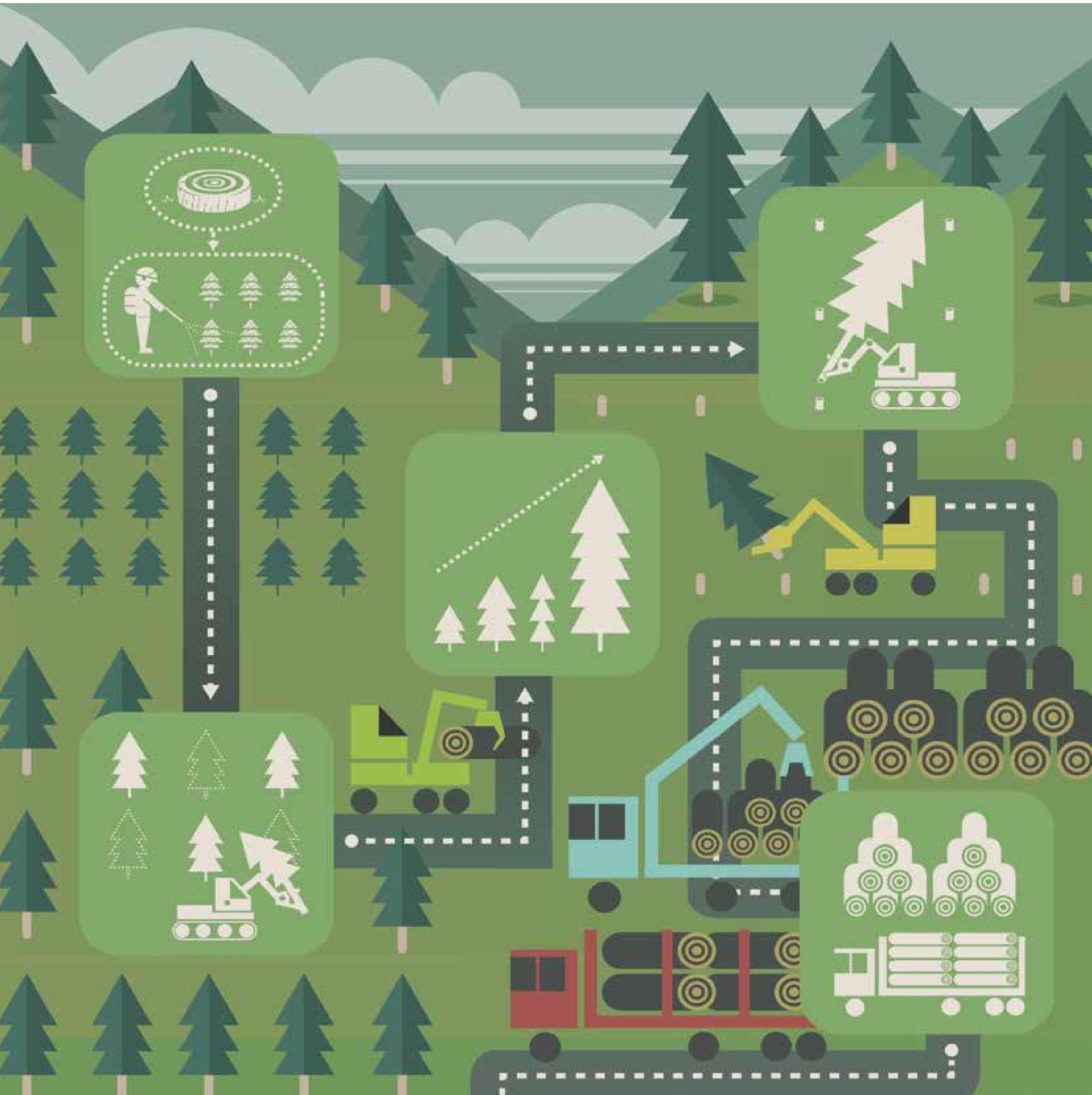
Spotlight | 2018

UK Forestry Market



Foreword

The requirement to secure wood fibre seems to be the dominant driver

The UK has languished in a low interest rate environment since March 2009 when rates were reduced to 0.5% to provide stimulus to the economy in the maelstrom of the financial crisis. The same crisis has much to do with the current buoyant state of the UK forestry investment market, driving cash holding investors to look for alternatives in real assets. Forest ownership is perceived as straightforward, long-term and low risk and was seen as a safe haven in those troubled times.

So how has forestry performed? Based on our market research, cash on deposit would have accumulated 19% in value before tax over the period since the financial crisis, however a spruce tree growing on a hill in South Scotland would have accumulated 36% in value tax free over the same time, simply as a result in the change in size of the tree. Excellent performance in its own right, but factor in inflationary growth in capital market value and the performance is boosted to over 80%.

At the date of writing, the best savings interest rate to be found on moneysupermarket.com was 2.51% for a five year fixed-rate bond from a challenger bank. The questions in my mind are therefore, at around 8% per annum, why not trees and, how long can this performance continue?

Looking at the market in 2017, although the area of forest traded was down slightly on 2016 it was near to the medium term average, therefore there was product available for would be investors.

However, despite the small drop in area traded, the overall value of the market rose by nearly a quarter demonstrating another strong rise in underlying average capital values. Based on the key principles of property investment, strong increases in capital value must feed through to downward pressure on the returns achievable, whether actual or claimed.

Demand is, of course, not constant across all woodland types and is strongest for productive timber forests with late rotation spruce plantations exhibiting some exceptionally competitive sales during the year. A requirement to secure wood fibre appears to be the dominant driver and as we have reported for several years, the obvious taxation benefits of owning commercial woodland have slid in importance.

Positive news stories

As in previous years, woodland with mixed conifer species or any property with land or access constraints has been slower to sell unless keenly priced. Demand for amenity and small woodlands appears to be strengthening again driven by returning consumer confidence and wider understanding of the benefits of woodland ownership.

Timber prices have posted strong growth during the 2017 forest year (1st October 2016 to 30th September 2017), benefiting from both weaker sterling and strong demand for roundwood from domestic mills. Demand for small roundwood is pushing from the bottom which has set a floor price, due to increasing domestic demand from sluggish imports and a cold winter.

New planting continues to provide positive news stories with application levels in Scotland beginning to approach government targets, but other areas of the UK continue to exhibit slow progress, despite plenty of seemingly positive encouragement.

We consider land value as a key constraint and there is a pinch point where forestry cannot compete. Our research shows that the average land value in England is just under £8,000 per acre, or £5,000 per acre for poor livestock land. However, in Scotland, where a lot more planting takes place, suitable land is generally below £2,000 per acre, meaning the case for conversion to productive forest is easily made. ■

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Market update

The UK forestry market posted another year of strong performance

Despite general uncertainty in the property world surrounding the potential effects of Brexit, the UK forestry market continues to demonstrate a degree of resilience and posted another year of strong performance.

Underpinning the forestry market, domestic timber, supported by a weaker sterling and the increasing demand for wood in biomass and construction, continues to drive value in the forest property sector.

Average forestry values are diverse and factors such as location, access, tree species, average age and timber volume/quality all have an influence on the price paid which varies across the regions.

During the 2017 forest year the total value of the forestry investment market increased by 24% to over £112 million compared with around £90 million in 2016. Although this is significantly lower than the £146 million in 2015, the value of forestry transacted during 2017 is still 25% higher than the medium term average (Figure 1).

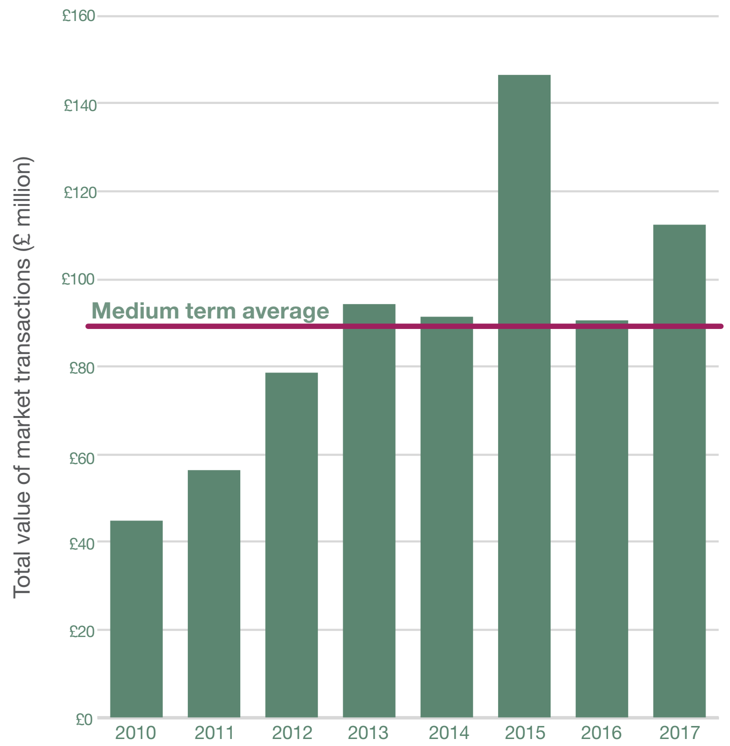
Despite this large increase in the overall value of the market, the total area of forestry sold across the UK actually fell to just over 18,000 hectares during 2017 representing a reduction of -8% on the 2016 forest year (Figure 2), but to a figure close to the medium term average. Contraction of the market area coupled with an increase in the overall value traded resulted in rising average values.

In all properties there are areas that are unplanted such as lochs, rivers, rides and tracks. These unproductive areas have a relatively low and fairly constant value, therefore the amount of productive and unproductive areas in a forest will have a significant effect on the price paid.

Our recent research reveals average productive values across the UK rose by 20% to £9,300 per hectare. This significant growth follows a fall in average values during the previous year, although in 2016 this was largely due to the location of properties traded with over 80% north of the Forth-Clyde canal.

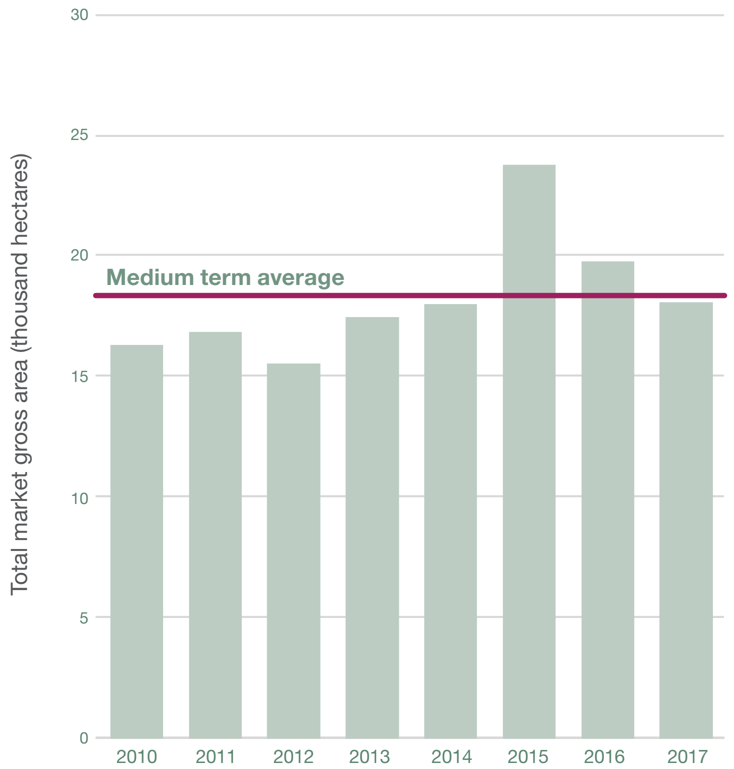
In 2017 gross values grew by 19% to £7,300 per hectare. On average productive values were 27% higher than the average gross value and the average unproductive area was 32% per property. ■

FIGURE 1 **Total market value**



Source: Savills Research

FIGURE 2 **Total market area**



Source: Savills Research

FORESTRY INVESTMENT ANALYSIS

FIGURE 3 Regional average values

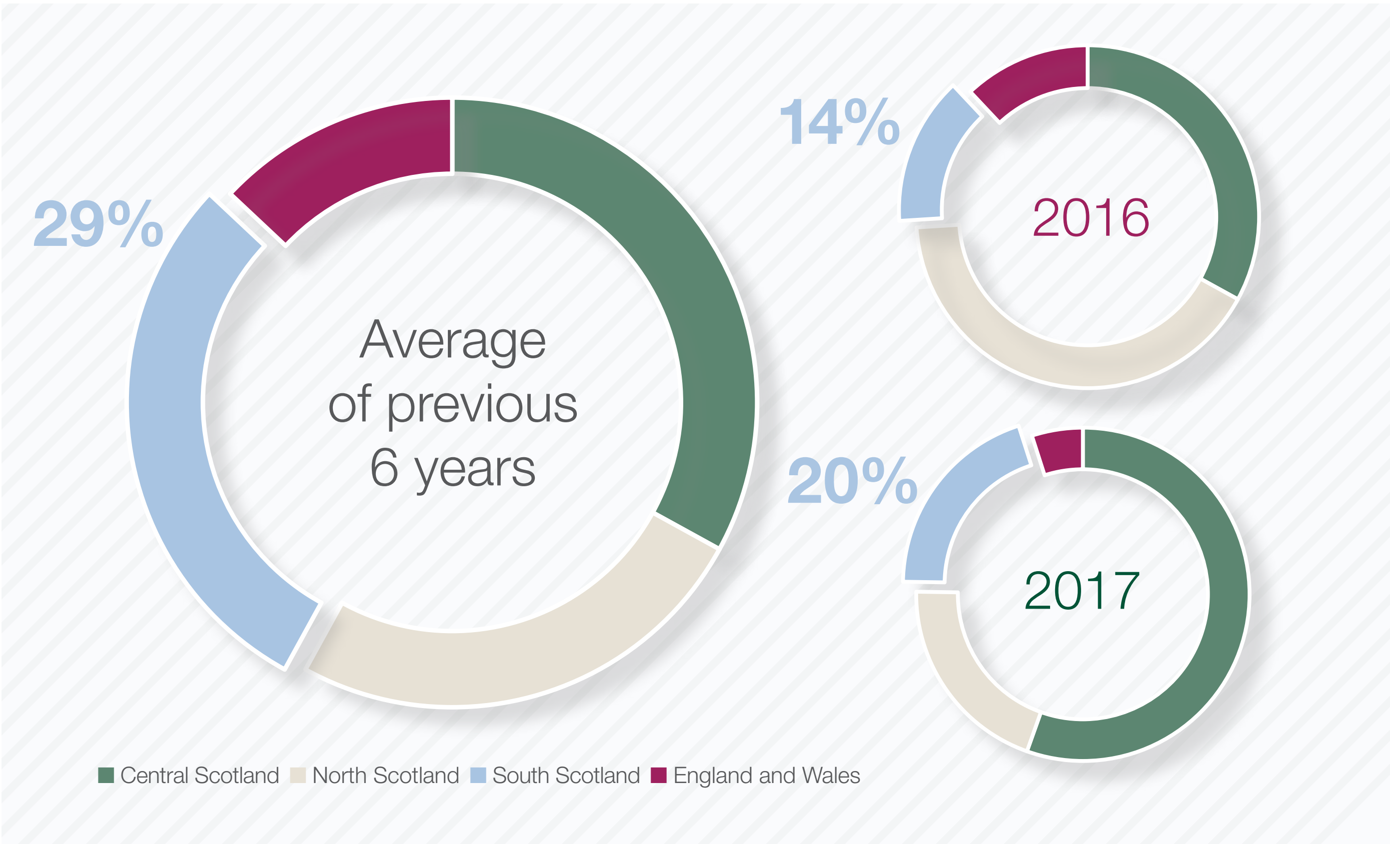
	£ per productive hectare 2017	% change 2016-2017	Average 2011-2016, £ per productive hectare	% change from average (2011–2016) to 2017	Six-year annualised rate of capital growth to 2017
Central Scotland	£8,800	34%	£6,300	40%	10%
North Scotland	£3,500	35%	£3,000	16%	11%
South Scotland	£12,800	21%	£9,100	40%	14%
England and Wales	£16,300	50%	£8,100	102%	22%

Source: Savills Research

Figure 3 above illustrates strong value performance across all of the four regions analysed during 2017, with average values in the north of Scotland showing the lowest change to average prices, reflecting the lesser competition for property in this area. In 2011, the difference between the maximum range in values was around £4,000, which compares to £13,000 in 2017 indicating increased divergence in regional values over recent years.

> Total value of the forestry market increased by 24% to just over £112 million during the 2017 forest year.

FIGURE 4 Regional market share



Source: Savills Research

Regional performance

England and Wales

The highest average productive capital values were achieved in England and Wales with the average price rising by 50% to £16,300 per productive hectare (Figure 3). Although this level of increase seems very high we would caution that this is over a very small sample size and the high value appreciation is largely due to demand dependant factors: firstly, there is an increasing recognition of the value of productive woodland in England and timber returns are improving, increasing interest in the sector; secondly, there is a real scarcity of productive woodland for sale as demonstrated by the market share (Figure 4), where England and Wales posted the smallest market share since 2012.

South Scotland

Our research reveals average productive values rose by 21% to £12,800 per hectare in South Scotland. In addition Figure 4 shows that the proportion of hectares sold also increased during the 2017 forest year.

South Scotland tends to achieve higher average capital values compared to the rest of Scotland due to the favourable physical conditions for growing timber and the highly competitive nature of the timber industry in this region. Sales generally completed quickly for strong prices.

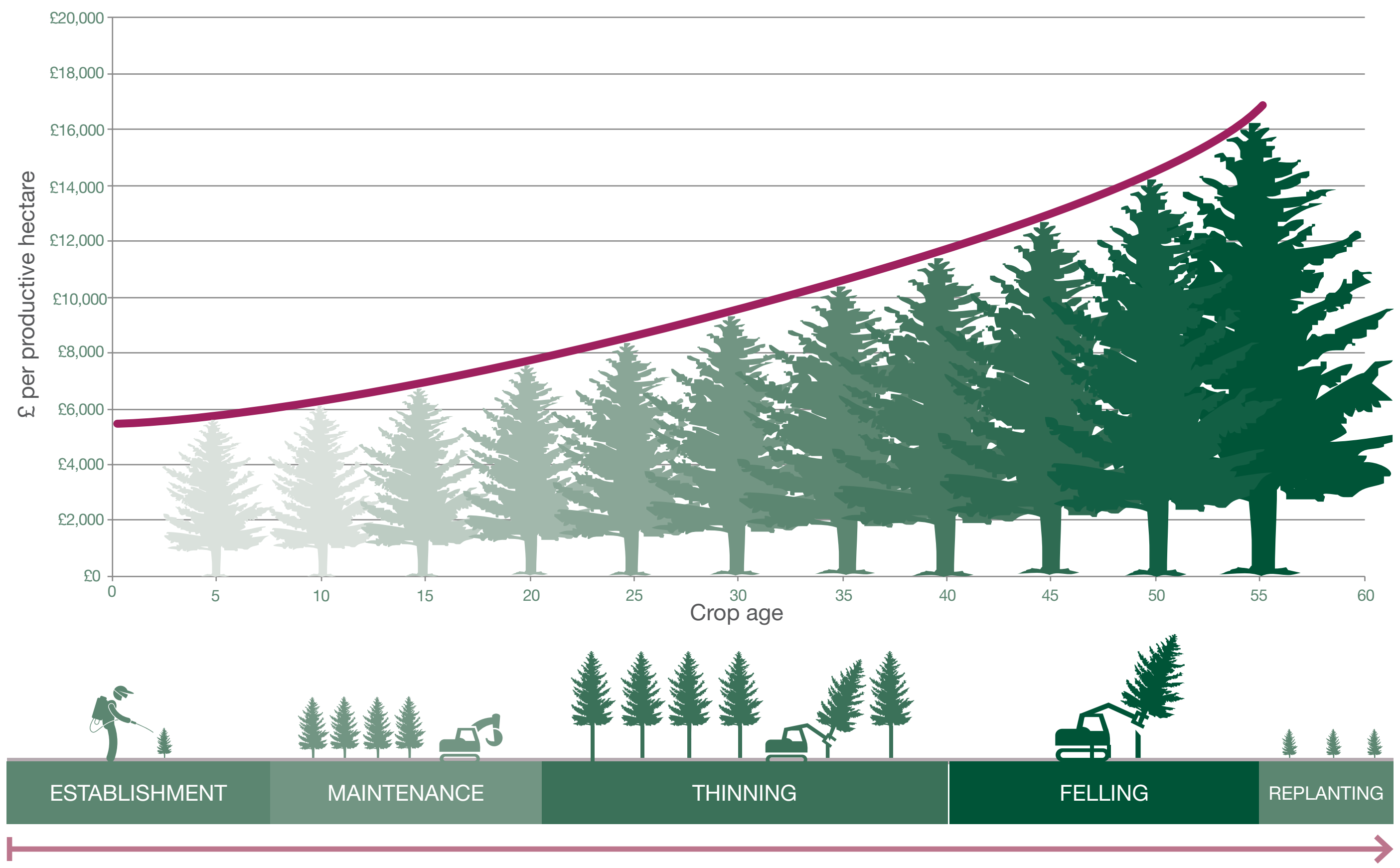
Central Scotland

Central Scotland returned a 34% rise in average productive forest values during 2017 and had the largest market share (56%) (Figure 4). The high rate of growth in average value was largely as a result of lower average prices in 2016 and if you compare with 2015, the rise is 10% which is more representative of the market.

North Scotland

Although the number of hectares sold in North Scotland fell during the 2017 forest year, the average value increased by 35% to £3,500 per productive hectare. Due to the terrain and the reduced opportunities for marketing timber, North Scotland traditionally has lower values and with the exception of the increase in 2014, prices have remained fairly static over the past six years.

FIGURE 5 Age and value profile, £ per hectare, UK (2017)



Source: Savills Research

Timber market

Timber prices showed real term growth of 18% over the year

The Forestry Commission Standing Sale Price Indices, September 2017 shows sharp upwards movement since September 2016 reflecting exceptionally strong demand for both sawlogs and industrial roundwood.

The timber processors have had to deal with a combination of factors influencing their markets. At the beginning of 2017 sawlog demand increased to sustain higher levels of sawmill production and prices increased steadily as competition for supplies intensified. End user demand was not constant across all product categories and conversely, the availability of industrial roundwood increased during the first half of 2017 and prices were subdued.

By the summer supply and demand were more balanced and industrial roundwood prices stabilised. Throughout the final quarter demand and prices increased because of additional processing capacity and a reduction in availability of wood chips and sawdust as sawmill production levels dropped in reaction to the lack of sustainably priced sawlogs.

Prices have continued to increase and when the Forestry Commission publishes the Standing Sale Price Indices to March 2018 it is expected to show a further price escalation. The current market conditions are expected to remain unchanged throughout the first half of 2018.

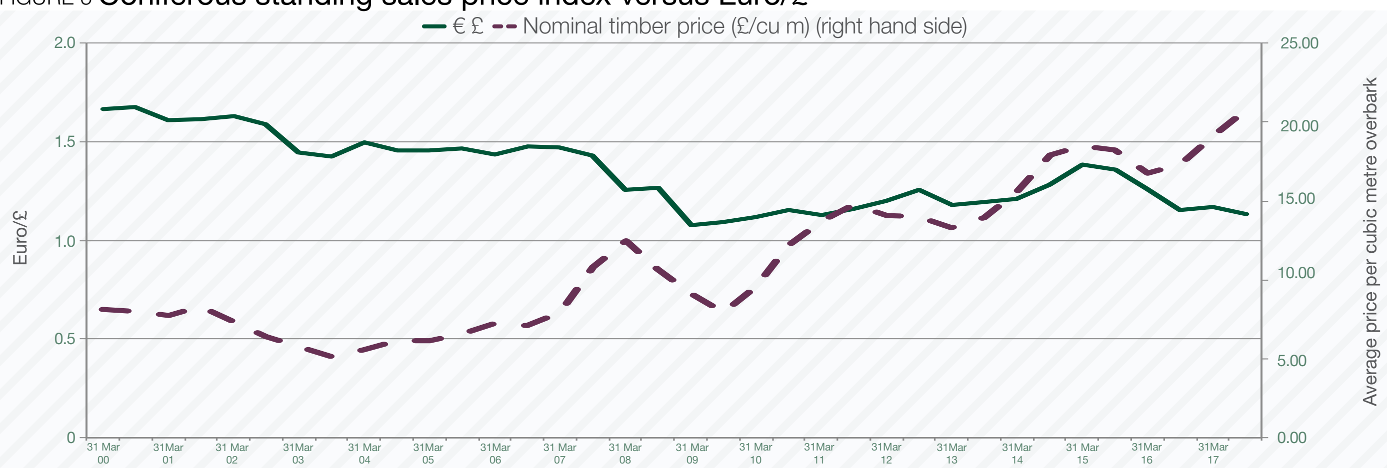
Two of the fundamental factors that influence the timber market are new house building and exchange rates. According to the National House Building Council (NHBC), which covers around 80% of all new homes built in the UK, new home completions were up 4% in 2017 and the Government statistics for the first half of 2017 show completions of 92,280 which is the highest level since 2007.

In the autumn budget, the Government announced that it was “determined to fix the broken housing market, and restore the dream of home ownership for a new generation” and pledged to raise the housing supply to 300,000 per year, on average, by the mid 2020s which would be the highest level since the 1970s.

Although the detailed approach may differ, the need to deal with the housing crisis has broad political support which provides a degree of optimism that a substantial increase in new house building will be achieved.

Sawn softwood consumption is strongly correlated to new house building activity, so any increase in this sector should have a positive effect on UK timber prices. ■

FIGURE 6 Coniferous standing sales price index versus Euro/£



Source: Forestry Commission and Savills Research

Creating a future resource

Progress on new planting targets and ongoing opportunities

There is little doubt that in Scotland the current Government's aspirations put forestry high up the agenda, mainly due to climate change targets, outlined in the Climate Change Plan, as part of the Climate Change (Scotland) Act 2009.

There is also a recognition of the positive contribution that forestry makes to the rural economy, through increased new planting, along with timber harvesting and marketing activity based on the extensive plantings in the 1970s and 1980s.

What is still lacking, however, is a real strategy to support this development and to integrate it with the other land uses which have a stake in rural Scotland. The Scottish Forestry Strategy was produced in 2006 and despite updates is now out of kilter with the new aspirations.

Encouragingly, there is a commitment to the delivery of a new Scottish Forestry Strategy, which is required by the Forestry and Land Management (Scotland) Bill and which will be in place by April 2019.

As momentum for planting builds, so does concern about alternative land-use in traditional stock rearing areas. It is hoped that this new inclusive strategy will go some way to alleviating the apprehension of the agricultural sector in the increasing expansion of forestry planting.

Increase in planting numbers

The outcome of the greater push for forestry in Scotland has resulted in a significant increase in planting figures, and over the past 12 months it is likely some 8,000 hectares of planting will be approved, which is 2,000 hectares up on the previous period.

When taken along with the public sector planting carried out by the Forestry Commission at 900 hectares, we are heading in the right direction to achieve the current target of 10,000 hectares per annum, and, importantly, for the processing sector, this is also close to the target of being 60% productive conifer (see Figure 7).

In England, the long-term aim of forestry expansion is to see an increase from 10% woodland cover (2017) to 12% woodland cover by 2060, some 260,000 hectares or roughly 6,000 ha per annum. With the Government having “reset the clock” on the much promoted 11 million trees in the period of the Government (now June 2017-2022) there seems to be some disparity in these figures which suggest delivery of 800-1,000 hectares per annum.

Despite some excellent large schemes gaining approval in late 2017, this would appear to be an uphill battle. The recent announcement of the ‘Northern Forest’, a 50 million tree, 25-year project to establish woodland along the M62 corridor will undoubtedly help.

Planting targets in Wales, under the Woodlands for Wales Action Plan, are pegged at a short-term aspiration of 2,000 hectares per annum up to 2020, having been closer to 5,000 hectares per annum under the Climate Change Strategy for Wales.

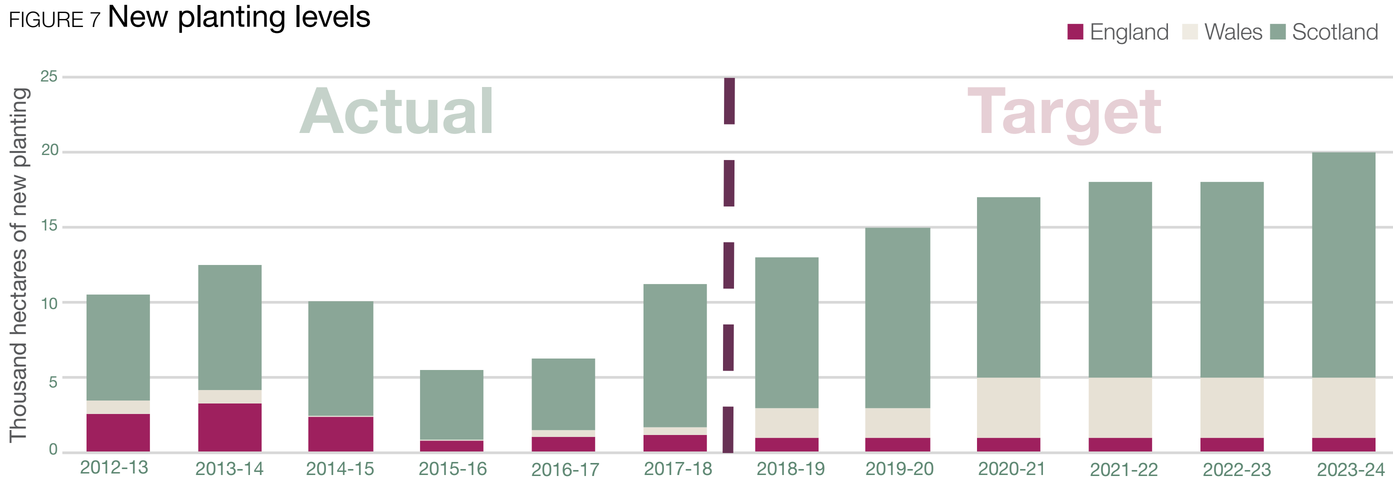
With new planting in 2014/15 and 2015/16 being less than 100 hectares per year and in 2016/17 some 400 hectares, there is a considerable way to go on these targets and it is clear that the aim of establishing 100,000 hectares of new woodland between 2010 and 2030 is unachievable.

Significant task ahead

So, while planting outcomes are currently close to the aspirational targets in Scotland, there is a significant task ahead for other areas to reach their stated planting objectives and land availability and high prices will hinder this process.

Funding will also play a vital role in a post-Brexit rural landscape with a high likelihood that money available will be challenged to meet an ever widening range of objectives. ■

FIGURE 7 New planting levels



Source: Forestry Commission, Savills Research and Scottish Woodlands

Global forestry

Worldwide trade of timber is on the rise

The economic, social and environmental contribution of our global forests is increasingly important. The demand for timber and processed wood products underpins trade in global timber markets. Economic growth, exchange rates, policy, technological advances in processing and the growing global interest in promoting the benefits of using wood all have an influence on demand.

A closer look at the global perspective supports a positive outlook for European and indeed UK forestry and wood products. The UNECE (United Nations Economic Commission for Europe) and FAO (Food and Agricultural Organisation of the United Nations) are forecasting increased wood consumption in the ECE (Economic Commission for Europe) region during 2018.

However, the UK is one of the least densely forested countries in Europe with around 13% forest cover (Figure 8). This compares with 38% for the EU as a whole and 31% worldwide. In contrast, the UK also has less than 1% of the global population but is the third largest importer of sawn softwood and in 2016 imported over 5% of the globally traded volume. The UK was the largest global consumer of wood pellets in 2016 with 26% of global consumption compared to America at 22% and Germany at 3%.

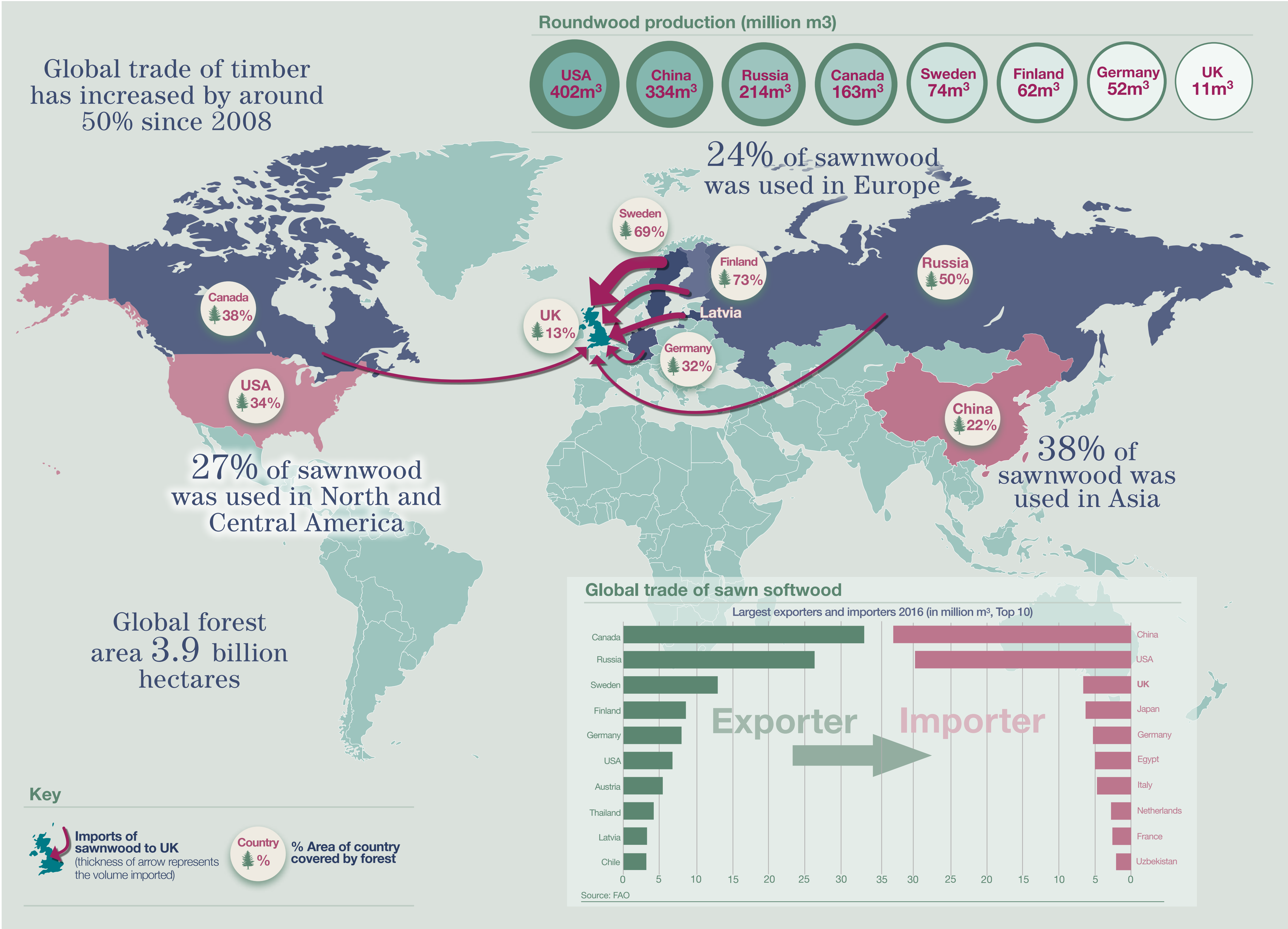
Increasing demand worldwide

Timber demand is increasing worldwide; the US market is particularly strong and in 2017 over 1 million m³ of sawn timber was imported from Europe (almost double the 2016 volume) and some of the large Swedish and German sawmilling companies have now established terminals in the US east coast to service their customers.

On the back of this increased global demand the UK is falling behind the global price with the inevitable consequence being that larger quantities are being shipped to alternative markets. This is affecting the availability to UK importers, however this will strengthen the position of the domestic sawmills and should provide opportunities to increase prices and market share.

By 2055, which is in less time than it takes to grow a spruce tree to maturity, the global population is forecast to increase by 36% and it is seems unlikely that global timber production will increase at a similar rate putting increasing pressure on available resources.

FIGURE 8 UK forestry in a global context



Source: UK Government Statistics, FAO of the United Nations, Forestry Commission, Wood Resources International LLC, Savills Research & Scottish Woodlands

Outlook

The backdrop of a rising global population is generating a locked-in demand

The market in 2017 was characterised by a very 'normal' level of stock traded, but a sharp rise in the average price paid. There remains a general lack of high quality investment plantations being actively marketed and indeed, much of the recorded sales activity occurred late in the period. The appreciation in average price was considerable at nearly 20% over the year. Based on our longer term dataset, average productive values have increased by around 325% over 20 years, representing a compound annual growth rate of around 8%.

In the introduction we posed two questions; at around 8% why not trees and, how long can this performance continue?

Why not trees? This is not hard to answer as the case for forest ownership seems compelling and at the moment the asset class can appear to do no wrong – the main issue is difficulty in getting into the asset in the first place. The underlying fundamentals are based on the sustainable production of a useful commodity with monetary value against a back drop of a rising global population generating locked-in, long term demand.

In the UK this is coupled with a capital market offering investors a ready exit at any time, generating strong returns in a favourable taxation environment. Put simply, there should be a place for forestry in all well balanced real estate investment portfolios and there remains strong upside potential from rising timber prices.

Long term investment

Turning to how long can this level of performance (around 8% CAGR) continue and the answer is less clear. Investment theory suggests one of the key factors in investment performance is the position in the cycle at purchase. Forestry is a long term investment, and the market we are in at present has not really seen a downturn, as during the last period of deflation in capital values (late 1990s) there was not the mainstream capital market we see today. In the five years to 2002 the average value per hectare was £1,800, however in the five years to 2017 the same figure was £8,200 and so it is easy to see how high returns were achieved.

Forestry traditionally has a very low cash yield as the income is lumpy and irregular, whilst the costs of maintenance and management are annual. This means it is misleading to compare it with other forms of yield driven property investment where income flow is paramount. On the basis, therefore, that much of the historic performance is based on the change in average capital values, for the market to repeat this level of performance we would need to see a similar level of capital increase which would mean the average capital value would need to be around £28,000 per hectare by 2037. Whether or not this is achievable can only be speculation at this stage.

Short-term demand factors

We predict UK timber prices to continue to be dominated by short-term demand factors which look steady for the first part of 2018. The sustainability of timber prices is a consideration and over the medium-term the price of sawn wood must rise to support the current level of forest gate prices. Increasing demand from domestic house builders could provide the catalyst for this.

Supported by financial incentives, biomass uptake continues to provide increasing impetus to the industrial roundwood sector but we have some concern that difficulties in sourcing imports and strong marginal pricing has the potential to divert supplies of higher quality wood into biomass, which is not the best use of this material.

New planting remains an area of focus. 2017 saw some progress in England, and Scotland is now beginning to reap the benefit of strong Government support and a keen industry, however there is still much to be done in this sector.

The availability of physically suitable land at an appropriate price remains the biggest challenge. However, given the recent performance of forestry perhaps the question now should be 'give me a good reason why I shouldn't be planting trees next year?'

Scotland's sporting rates

Deer control is a key element of management rather than simply sport

As part of the reintroduction of sporting rates in Scotland, forestry and woodland holdings have now been entered on the Valuation Roll with a flat rate assessment of £5 per hectare. Most properties received their Deer Forest/ Shooting Rights Valuation Notices in the 'phase 1' issue of assessments, and the window for lodging an appeal closes on 31st March. In the absence of lodging an appeal for a phase 1 assessment the opportunity to contest a valuation is lost until the next national revaluation, 1st April 2022.

Forest property received a flat rate £5 per hectare assessment. In many cases Small Business Bonus Scheme relief is available but it is subject to annual review, and it may not be there in the future. Certainly claim if you can, but we do not think it should be regarded as a reason not to appeal your assessment.

Savills has been advising forestry clients and businesses that it is important that forest owners and related shooting tenants should appeal their assessments, as apart from anything else, uncontested valuations risk providing the assessors with more evidence.

The assessors did not have the time nor the resources to do a thorough exercise before they had to issue the first tranche (phase 1) of Valuation Notices.

Disability allowances, area exclusions and regional/ geographical differences have not been taken into account, nor have "factors relating to deer management" been addressed (as provided for in the legislation).

These are all matters which could have a very material effect upon a sporting rights valuation. However, changes to a valuation assessment will now have to be resolved through the rating appeals process, and it is unlikely that these will be heard for some considerable time.

It is hoped as the appeals process develops, many commercially managed forests, where deer control is a key element of management rather than simply sport, will be re-assessed to nominal and in some cases possibly a nil value.

There is a clear conflict between the concept that sporting rights on lands and heritages (including woodlands) must now be placed on the Valuation Roll and the primary objective of growing timber within commercial forestry.

Savills will continue to play a key role in the ongoing dialogue with the Scottish Assessors Association (SAA), and Scottish Government.

Forest Investment Analysis

Methodology: Our research analyses our transactional database of forest sales. This database collates data from all mainstream forestry transactions, and where we are aware, off-market or private sales.

While every effort is taken to ensure all transactions are included within the information presented within this publication, it is very likely that further sales are known about following the launch of publications. Therefore, historic data previously reported within our 'Spotlight On The UK Forestry Market' 2015, 2016 and 2017 has been updated to take account of new available information within the marketplace.

About Scottish Woodlands

www.scottishwoodlands.co.uk

Scottish Woodlands Ltd is a leading forest services provider with a long tradition of serving forest owners and investors in Scotland and the rest of the UK. Founded over 75 years ago, we are client and customer focused and operate to the highest standards of safety and environmental awareness. We actively manage around 200,000 hectares of forestry and in 2016/2017 harvested and marketed over 1.1 million tonnes of timber, and planted over a third of new woodland creation schemes across Scotland. The Company operates from a network of 15 offices around the UK providing a combination of local knowledge with national support.

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