THE TIMES

Monday August 19 2024 | THE TIMES

Business

Why every investor is getting deep in the forest

Patrick Hosking Financial Editor

Olly Hughes pointed across a misty Scottish hillside to a huge machine harvesting trees as if they were stalks of wheat. The articulated beast on caterpillar tracks grabbed the base of a 100ft sitka spruce, sliced it free from the ground, lifted it into the air like a pencil, stripped it of all bark and branches and reduced it to neat lengths. All in 30 seconds.

The days of lumberjacks with chainsaws are long gone. This is the world of modern-day forestry. A skilled driver in a £500,000 "harvester" can fell 450 trees in a day. The sweat has gone, too. The driver sits in a self-levelling cab, cushioned from the lurching and sawing beneath his feet, free from the local ticks and midges.

Technology is changing even the seemingly immutable business of planting saplings, pausing for decades, then cutting them down for timber. And so are attitudes in the investment world, where forestry is starting to be seen as a must-have asset class, a key component in a healthily diversified portfolio, alongside listed shares, private equity, property, government bonds and so on.

Hughes, 52, a former Barings banker, is one of the kingpins in this sector. He heads the forestry division of Gresham House, the biggest manager of forestry investments in Britain and a top ten forestry investor globally. Gresham manages timber investments worth £3.5 billion for, among others, the Church Commissioners, the Pension Protection Fund, Worcestershire Pension Fund and Axa, the French insurance group, as well as thousands of wealthy individual investors.

He is a persuasive salesman for the asset class. Trees don't stop growing simply because the economy shrinks or interest rates are raised or if the world is hit by fresh political shocks. That underlying natural growth is boosted by favourable trends such as soaring long-term demand for timber as a sustainable building material and by constraints on supplies. On top of that there are income kickers, like the opportunity to sell carbon credits, the scope for sub-letting parcels of forest floor to wind farm operators, even payments for flood mitigation. Planting trees is a much cheaper and greener form of mitigation than building concrete embankments.

By some measures, the investment returns have been very strong. "Timber is probably at the same level over the last 30 years in terms of total compounding growth as the S&P 500 [the leading American share index]," Hughes said. "However, what it hasn't done is gone through a rollercoaster ride of the dot-com bubble, the financial crisis, all these things. It's had a pretty straight trajectory."

And it's about to go mainstream. Nest, the National Employment Savings Trust, Britain's default state-backed pension scheme, has just appointed Campbell Global, JP Morgan's forestry business, to put £550 million into land for timber over three years. Pretty soon 12 million auto-enrolled employees in Britain will be betting 2p in every pound they save on timber. One way or another, we are all becoming forestry investors now.

The sector has had a bad rap. In the 1960s and 1970s, poorly structured tax breaks channelled billions of pounds into unsuitable projects. Large tracts of peat bog in Sutherland in the Scottish Highlands were planted out in firs, destroying the carbon-capturing quality of the peat while enabling the super-rich to dodge tax. Densely planted single-species forests blanketed some areas, reducing biodiversity, restricting access to the countryside and spoiling views.

Those days have gone, according to Hughes. On the other side of the Dumfries hill from that dinosaur-like harvester, there lies a recently purchased former sheep farm, Bush of Ewes, which is being converted to forestry. Newly planted broadleaf trees such as oak, alder, birch and rowan stand beside a track and follow stream gullies up the hillside. While fast-growing sitka spruces are still the dominant species, others such as Scot's pine, lodgepole pine and douglas fir provide variety. Hilltops, where peat tends to be at its deepest, are left unplanted. Purple heather fills the margins.

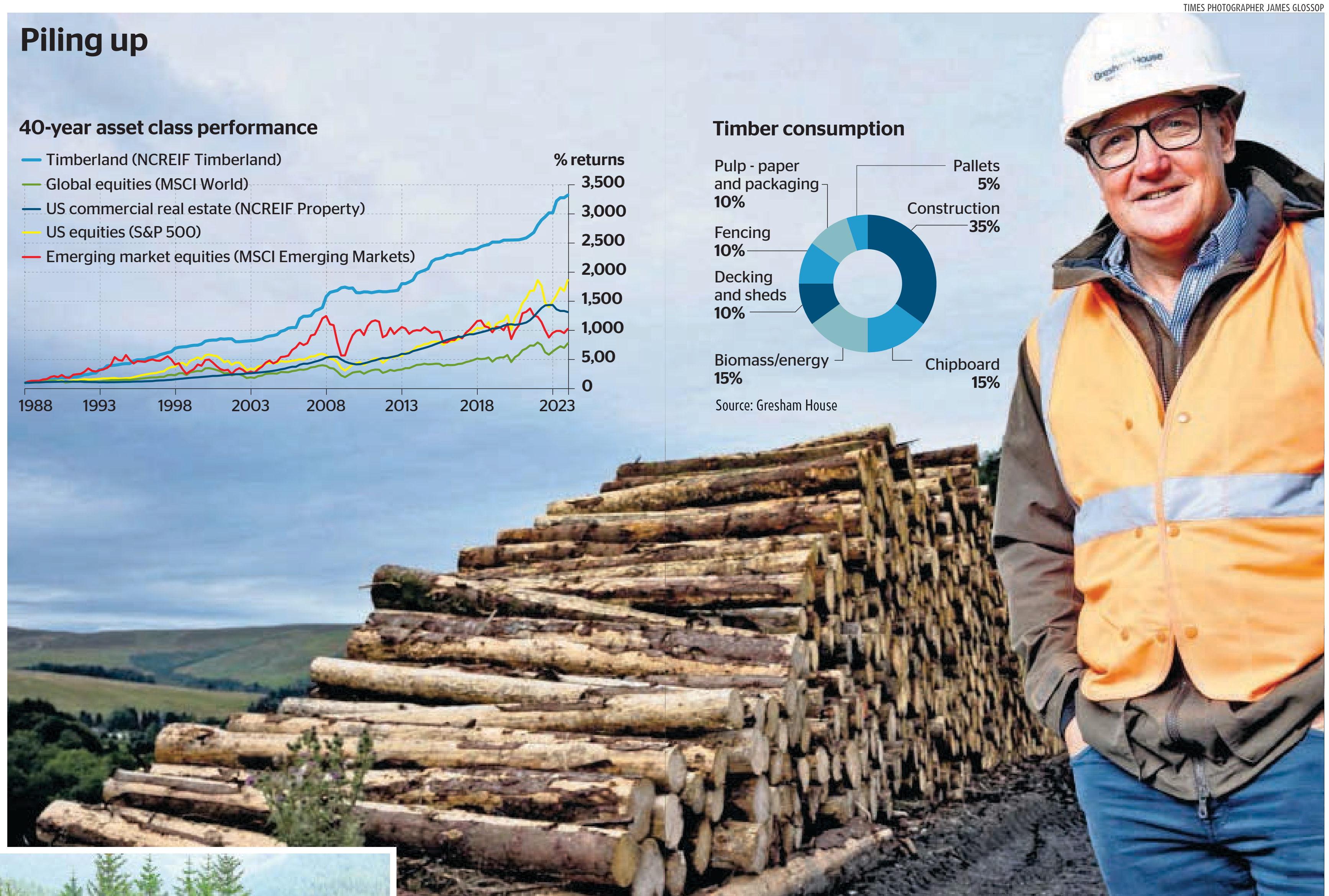
Stricter rules on species variety and peat protection are forcing foresters to change their ways. Nest has emphasised the environmental benefits as a key reason to plunge its members' money into forests. Forests absorb and store carbon, helping to take one small step on the road to net zero, while increasing exposure to "natural capital", the buzzword of the moment.

Sitka spruce can grow by more than half a metre in the space of a year. It explains why sitkas have become the super-species for commercial forests. They can reach maturity in as little as 30 years, therefore delivering the highest rate of return. Other pines can take 70 to 80 years, while broadleaf trees are even slower.

Some jobs in forestry remain highly labour-intensive. Saplings in Bush of Ewes have been hand-planted by local "planting squads". It's back-breaking work, but a skilled worker can plant 1,500 to 2,000 saplings in a day. They get paid 15p to 16p per tree, said Matthew Giles, who learnt the forestry trade from his father and is the Gresham forestry division's investment director. "It's the only way to inspire them when the rain's coming in sideways." A quick spot of mental maths suggests £225 to £320 a day. Not bad, but the midges must make it a misery sometimes.

Britain is notoriously thin on forestry, with only 13 per cent of land covered by trees. That compares with up to 30 per cent in much of Europe and more like 70 per cent in Scandinavia. The government wants to lift that proportion, to raise carbon absorption and to reduce dependence on timber imports. Eighty-eight per cent of timber in the UK is imported. Several tax breaks continue: income from timber revenues is tax-free, while it is also treated generously for capital gains tax and inheritance tax.

The tax benefits still appeal to wealthy individuals. Gresham raised a £300 million fund two years ago, tapping both retail investors (the minimum investment was £100,000) and institutions. It is now raising money for a sixth fund. The funds typically are assigned a blended portfolio of holdings ranging from new plantations to mature stock. This produces what Hughes calls a "perpetual" round of harvesting and restocking that delivers an annual cash yield of 2 per cent. Most of the total gains are made in the form of capital gains when these closed-ended, limited partnership funds are wound up, typically after 15, 20 or 25 years. Gresham claims a total annual return after fees of just over 12 per cent averaged across four of its funds over the past ten years.



TIMES PHOTOGRAPHER JAMES GLOSSOP

Olly Hughes, who heads the forestry division of Gresham House, says that timber offers attractive returns without enduring the "rollercoaster ride" of stock markets

Forest valuations have come down by about 10 per cent to 15 per cent over the past 18 months on the back of weaker timber prices. Some timber prices leapt dramatically during the pandemic when locked-down households treated themselves to new decking and fencing. Supply chain bottlenecks produced another price surge at the start of the Ukraine invasion. Gresham tries to insulate itself from the downturns by pausing tree-cutting in the lean times. There is a ten to fifteen-year window when mature trees can be felled.

Hughes believes that the asset class is about to go into a fresh growth phase because of the imbalance between demand and inelastic supplies. Gresham is positing that the long-time growth in global demand for construction-quality timber will accelerate from about 1.1 per cent a year to nearer 3 per cent, boosted by the twin engines of global urbanisation and decarbonisation. Demand for new homes is soaring, while the switch from carbon-intensive materials such as concrete and steel to renewables like wood is only going to intensify.

Not all forestry investors have prospered. Last month Foresight Sustainable Forestry Co, a London-listed investment trust, was bought out at discount to its net assets after an underwhelming three years as a listed company. Other disappointments include Phaunos Timber Fund and Cambium Global Timberland, both of which were wound down. Excess leverage, bad timing and a lack of experience have all played their part in forestry disappointments in the past.

Those listed vehicles traded at yawning discounts to net assets, making it very difficult to raise fresh capital. Gresham's unlisted funds do not have that problem, although they are still subject to annual valuations by third parties. The underlying assets — trees — don't come much more illiquid than this, which can raise problems of valuation and may make the asset class unsuitable for investors who might want to sell in the short run.

Other risks include forest fires and pestilence: *ips typographus*, otherwise known as the eight-toothed spruce bark beetle, has decimated some forests in central Europe but so far has not ventured further north than Kent and Sussex in Britain. To judge by the scramble by pension funds to diversify into private assets, especially green-tinged ones, it will take more than a beetle to stop this advance.