

UK IPD Forestry Index

Results for the year to 31 December 2016

June 2017

The MSCI IPD UK Forestry Index measures un-gearred total returns from direct investment in a sample of private sector-owned coniferous plantations of predominantly Sitka spruce in mainland Britain (but mostly in Scotland (and southern Scotland in particular) and Wales). The 2016 sample is 142 forest holdings with a total capital value of £342m.

The results for the year to 31 December 2016, and over the last five to 20 years, are in the tables below.

Table 1: Investment performance of UK forestry compared with other core asset classes, in 2016, 2015 and over 5 to 20 year periods¹

| | 2016 | | | | 2015 Total Return (%) | Annualised total return (% pa) | | | |
|----------------------------|--------------------------------------|---------------------------------------|-------------------------------------|---|--------------------------------|-----------------------------------|-------------|-------------|-------------|
| | Income Return (%) ² | Capital Growth (%) ³ | Total Return (%) ⁴ | Gross Rent Passing Growth (%) | | 5 years | 10 years | 15 years | 20 years |
| UK forestry | -0.25 | 10.9 | 10.7 | - | 10.9 | 14.7 | 17.4 | 14.1 | 9.7 |
| UK commercial property | 4.7 | -0.8 | 3.9 | 3.3 | 13.1 | 9.7 | 4.5 | 7.9 | 8.9 |
| UK residential market lets | 3.2 | 2.3 | 5.6 | 9.1 | 7.1 | 9.8 | 8.4 | - | - |
| Equities | n/a | n/a | 19.2 | n/a | -2.2 | 8.9 | 5.1 | 5.7 | 6.2 |
| Bonds | n/a | n/a | 7.9 | n/a | 1.0 | 3.9 | 6.5 | 6.0 | 6.6 |
| Retail Price Index | n/a | n/a | 2.5 | n/a | 1.2 | 2.2 | 2.8 | 2.9 | 2.8 |

NB The UK Annual Rural Property Index will not be published this year and it is not clear whether the Index will continue to be published at all. Portfolios, like The Crown Estate and the Church Commissioners which contain rural property, will continue to receive data on the performance of their rural property from MSCI as part of their portfolio analysis service.

Table 2: Investment performance of UK forestry by region in 2016 and over the last 24 years (1992-2016)

| | 2016 | | | | 24 years |
|----------------|----------------------|-----------------------|------------------|--------------------------------------|--------------------------------------|
| | Income Return (%) | Capital Growth (%) | Total Return (%) | Receipts from timber sales (%) | Annualised total return (% pa) |
| UK | -0.2 | 10.9 | 10.7 | 4.7 | 9.1 |
| North Scotland | -0.3 | 14.1 | 13.7 | 0.1 | 8.2 |
| Mid Scotland | -0.9 | 8.2 | 7.2 | 1.4 | 8.8 |
| South Scotland | 0.2 | 8.9 | 9.1 | 5.3 | 11.5 |
| North England | -1.0 | 15.3 | 14.1 | 2.1 | 8.8 |
| Wales | -0.7 | 15.0 | 14.2 | 3.4 | 7.7 |

1 These figures exclude transactions, which is IPD's favoured measurement of returns. Including transactions, so sales from portfolios and uplift from development or tenancy reversions, typically adds 1-2% to total returns.

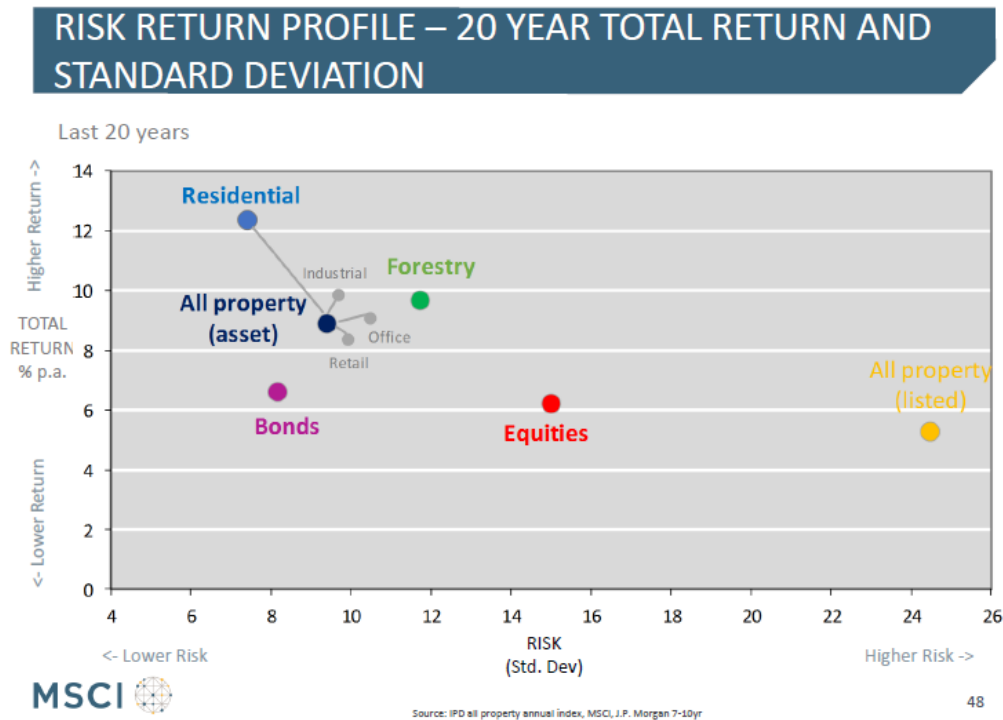
2 Income return is the net income generated by the property over a year (i.e., gross income less expenditure on property maintenance, management and other costs), expressed as a percentage of its capital value at the start of the year.

3 Capital growth is the increase in the capital value of the property from the start to the end of the year, expressed as a percentage of its capital value at the start of the year.

4 Total return is income return plus capital growth. The formula used to calculate it takes into account when income is generated during the year and so sometimes is not the same as simply adding income return and capital growth together, although doing so is usually accurate to within 0.1- 0.3%, so good enough!

5 The income return for forestry is negative due to lack of regular/contracted income. However capital receipts from timber sales amounted to 4.7% of mid-year capital value in 2016, and 3.7% over 13 years (2004 – 2016).

Chart 1: Total return (% pa) and risk (measured as volatility of the total returns) of forestry compared with other asset classes, over a 20 year period⁶



NB This chart does not show rural property which, for the 20 years to the end of 2015, had the highest return (@11% pa) and lowest risk (7 std.dev).

Table 2: Investment performance of UK forestry compared with other core asset classes, over a 10 year period.

| | 10 year annualised total return to 31 December 2016 (% pa) | | | |
|---------------------------------------|--|--------------------|------------------|-------------------------------|
| | Income Return (%) | Capital Growth (%) | Total Return (%) | Gross Rent Passing Growth (%) |
| UK forestry | -0.9 | | 17.4 | |
| UK commercial property (all property) | 5.6 | -1.0 | 4.5 | 0.8 |
| UK retail property | 5.6 | -2.3 | 3.1 | 0.0 |
| UK offices property | 5.3 | 0.4 | 5.7 | 2.0 |
| UK industrial property | 6.4 | -0.9 | 5.5 | 0.6 |
| UK residential market lets | 3.5 | 4.8 | 8.4 | 3.0 |
| Equities | n/a | n/a | 5.1 | n/a |
| Bonds | n/a | n/a | 6.5 | n/a |
| Retail Price Index | n/a | n/a | 2.8 | n/a |

⁶ Volatility is measured by the standard deviation of the total returns over the ten year period. The relationship between total return and risk is sometimes referred to as the Sharpe ratio.

**Key points on the 2016 Index performance are:**

- Total return was 10.7% in 2016, a slight drop from 10.9% in 2015 and below the ten year average of 17.4% pa. However it remains one of the highest performing asset classes.
- Capital growth remains the main driver of returns, at 10.9% in 2016, due to continuing strong demand for forest land as an investment.
- Capital receipts from timber sales were equivalent to 4.7% of the total value of the index. This can be loosely considered an annual income yield from forestry, although the income is lumpy, with most generated when a forest is thinned or felled.
- The tax reliefs on commercial forest investment did not change and continue to be held constant by successive governments.
- In terms of transactions of forest investments, 13,000 stocked hectares were sold, in 67 transactions, with a value of £79m, according to The UK forest market report 2016 by John Clegg and Co and Tilhill Forestry. This was an almost 50% drop from 2015's record £150m of sales, which was exceptional mainly due to the sale of UPM's portfolio worth £50m and the end of the Forestry Commission's disposal programme, and broadly similar to 2014's £82m of sales.
- Average capital values of forests in the Index in 2016 are: £6,100 per hectare in north Scotland, £6,340 in mid Scotland, £7,900 in south Scotland, £8,600 in north England and £7,100 in Wales.
- There is growing evidence of the forestry grant, administration and regulation system in England preventing the planting of new forest areas. This is shown by only 525 hectares of new woodland being planted in England in the year ending 31 March 2017, according to the Forestry Commission. This is massively below the national targets for planting. Most of the planting was done in early 2016 with very little planted since. Our experience, through John Clegg and Co, is that some remarkable issues are being raised to frustrate planting proposals, such as partial rush cover on one site.
- Planting in Scotland, which has a different governance structure, is likely to hit its annual target of 10,000 hectares a year and there are plans to increase the target further.

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