

SMARTER PERSPECTIVE: FORESTRY

More of the Same for Forestry Market in Q4 Warrants Remaining Close to Borrower Businesses

By Jesse Marzouk

In this article, we take a look at a continued softening in lumber markets, the associated drivers of that trend, and actions that can be taken by those with portfolio exposure to minimize the potential for downside risk.

HOUSING OVERVIEW

October marked the ninth straight month of declines in housing starts. Existing home sales fell to a seasonally adjusted annual rate of 4.43 million, while sales fell 5.9% from September and a whopping 28.4% from just a year ago. The median existing home sales price increased 6.6% from 2021 to \$379,100 and inventory of unsold existing homes for October slid for the third straight month to 1.22 million, which equates to a 3.3 month supply.



Building Permits

Privately-owned housing units authorized by building permits in October were at a seasonally adjusted annual rate of 1,526,000. This is 2.4 percent below the revised September rate of 1,564,000 and is 10.1 percent below the October 2021 rate of 1,698,000. Single-family authorizations in October were at a rate of 839,000; this is 3.6 percent below the revised September figure of 870,000. Authorizations of units in buildings with five units or more were at a rate of 633,000 in October.

Housing Starts

Privately-owned housing starts in October were at a seasonally adjusted annual rate of 1,425,000. This is 4.2 percent (± 12.7 percent)* below the revised September estimate of 1,488,000 and is 8.8 percent (± 12.7 percent)* below the October 2021 rate of 1,563,000. Single-family housing starts in October were at a rate of 855,000; this is 6.1 percent (± 13.4 percent)* below the revised September figure of 911,000. The October rate for units in buildings with five units or more was 556,000.

Housing Completions

Privately-owned housing completions in May were at a seasonally adjusted annual rate of 1,339,000. This is 6.4 percent (± 10.6 percent)* below the revised September estimate of 1,431,000 but is 6.6 percent (± 12.6 percent)* above the October 2021 rate of 1,256,000. Single-family housing completions in October were at a rate of 961,000; this is 8.3 percent (± 8.2 percent)* below the revised September rate of 1,048,000. The October rate for units in buildings with five units or more was 362,000.

**The 90% confidence interval includes zero. In such cases, there is insufficient statistical evidence to conclude that the actual change is different from zero*

Source: U.S. Census Bureau / U.S. Department of Housing and Urban Development

New single family home sales recovered a bit month over month in October, reaching a seasonally adjusted annual rate of 623,000. Notably, this is 7.5 percent over September's 588,000.

Although housing is less affordable than at any time in recent memory, prices overall are down only slightly. But with demand likely to be tempered by a lack of cheap money for some time to come, further decreases in value are widely expected. Record value run-ups in numerous markets could place them at risk. The below chart indicates markets that may be particularly susceptible over the coming 12 months.

More markets may also be at risk, given the combination of high housing prices and further anticipated interest rate hikes by the Fed for some time to come. KPMG Chief Economist Diane Swonk told Fortune in November that a 2023 housing price drop coming off the pandemic-induced housing bubble would be a "conservative" estimate. And with 30-year fixed mortgage rates now averaging more than 6.5%, the National Association of Homebuilders Housing Market Index indicates that confidence among single family homebuilders fell for an 11th straight month in November to a level close to the pandemic low registered in Q2 2020. With many Americans unable to purchase, or not interested in doing so right now, this confluence of events has also served to push residential rental rates to record highs as well. This is impacting consumers of all ages, life stages and socio-economic condition.

LUMBER MARKETS

As we approach the end of the year, lumber rates have continued to trend down from their heights earlier this year to \$500 and under per board feet this fall. Even still, these are still now at the very high end of a historical range seen over the course of the last 20 years,

New Residential Sales October 2022

New Houses Sold¹: 632,000
New Houses For Sale²: 470,000
Median Sales Price: \$493,000
Next Release: 12/23/2022

¹ Seasonally Adjusted Annual Rate (SAAR)

² Seasonally Adjusted

Source: U.S. Census Bureau, HUD, November 23, 2022

New Residential Sales

(Seasonally Adjusted Annual Rate)



Source: U.S. Census Bureau, HUD, November 23, 2022



Top Markets at Risk of Home Price Decline

Risk Rank	Metropolitan Areas	Level of Risk of Price Decline	Confidence Score
1	Crestview-Fort Walton Beach, Destin, FL	VERY HIGH ABOVE 70% PROBABILITY OF A PRICE DECLINE	50-75%
2	Bremerton-Silverdale, WA	VERY HIGH ABOVE 70% PROBABILITY OF A PRICE DECLINE	50-75%
3	Bellingham, WA	VERY HIGH ABOVE 70% PROBABILITY OF A PRICE DECLINE	50-75%
4	Eugene, OR	VERY HIGH ABOVE 70% PROBABILITY OF A PRICE DECLINE	50-75%
5	Tacoma-Lakewood, WA	VERY HIGH ABOVE 70% PROBABILITY OF A PRICE DECLINE	50-75%

Source: Core Logic Market Risk Indicator (MRI)



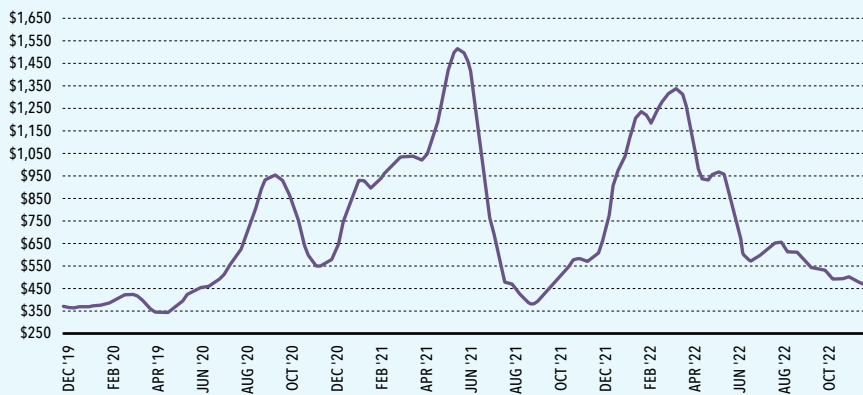
excluding the peak COVID period from the mid 2020 to mid 2021. Rates are not likely to get much lower until we see the cost of energy and labor come down.

Sawmills run on energy and moving lumber to and from them requires a significant investment in fuel. Even with energy and other costs running high at the mills as demand has decreased, business has not been bad enough for operators to lay off workers. The still-recent and unpleasant memory of not being able to secure labor following the peak of the pandemic has no doubt contributed to this stance. What we have seen mills do, however, is make certain operational adjustments including taking down time when demand has weakened to a level of around \$450 to \$400. Typical practice in the past has been to do so only when pricing dropped into the \$200 range.

While some analysts are forecasting the U.S. corrugated box market to grow by \$1.85 billion between 2022 and 2026, accelerating at a CAGR of 3.32% during that forecast period, the dramatic shift away from goods spending this year is putting downward pressure on packaging demand. While this was stemmed initially by the fact that many retailers and businesses had committed to orders and continued building stock even as consumer demand decreased and the trend became evident, U.S. actual corrugated box shipments in Q3 of this year fell by a substantial 4.5% Y/Y after experiencing a 2.3% Y/Y decline in Q2. This means 2022 U.S. actual shipments after three quarters were 7 billion ft2 less than in 2021. With two of North America's largest box makers taking large amounts of containerboard down time in Q3 with more expected in Q4, and consumer demand still waning, we are clearly seeing a period of notable inventory adjustment that may continue for some time.

According to the American Forest & Paper Association (AF&PA), October 2022 total printing-writing paper shipments decreased 4% Y/Y in October. U.S. purchases of printing-writing papers, however, increased 6% over the same period, while printing-writing paper

Random Lengths Framing Lumber Composite Pricing Last 36 Months (\$ per thousand board feet)



Source: Random Lengths

Framing lumber composite prices have continued their slide from a peak early in the first half of 2021, reaching their lowest level in over a year.



inventory levels increased 1% over the previous month, September 2022.

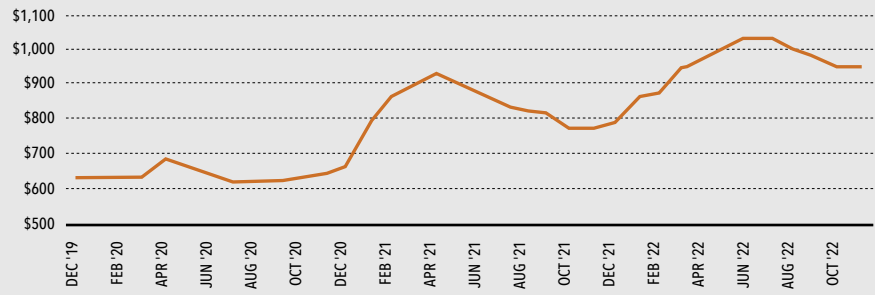
CONCLUSIONS

As the housing market goes, so does the lumber market. The confluence of elevated home prices and climbing interest rates have made new home

purchases unaffordable for many across the country. With housing starts down and builder confidence low, the current pricing trend is likely to continue. The impact is further amplified by reduced consumer goods purchase interest and activity. We encourage lenders to engage with their borrowers in the market to ensure a comprehensive



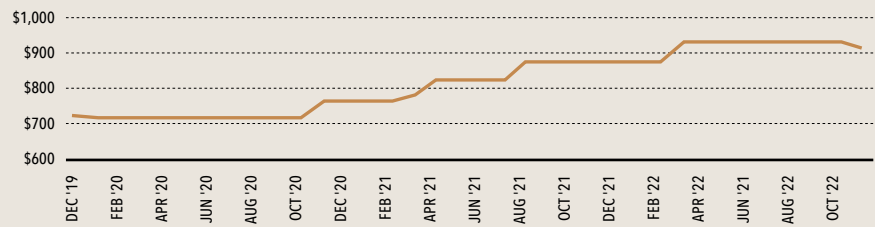
North American NBSK Pulp Spot Price 36-Month Trend (US \$ Ton)



Source: RISI



Unbleached Kraft Linerboard Prices (East Coast) 36-Month Trend (US \$ Ton)



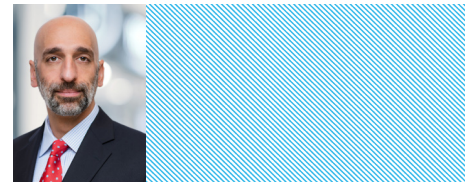
Source: RISI

North American NBSK Pulp Spot and Unbleached Kraft Linerboard pricing have both come down slightly from somewhat elevated levels. Domestic buyers are widely expected to push for further declines as the year comes to a close.



understanding of current business performance, notable challenges and forecasting accuracy. More frequent valuation monitoring may be a worthwhile consideration right now and we welcome the opportunity to discuss and assist in those efforts as well as to answer any questions you may have pertaining to specific exposure within your portfolio. As always, we are here to help during this continued, volatile period.

Hilco Valuation Services is the leader in valuation for the forestry and lumber industry, having delivered more than 500 forestry and lumber appraisals, with asset values ranging from \$500 thousand to \$1 billion. As one of the world's largest and most diversified business asset appraisers and valuation advisors, we serve as a trusted resource to companies, lenders and professional service advisors, providing value opinions across virtually every asset category. Hilco Valuation Services has the ability to affirm asset values via proprietary market data and direct worldwide asset disposition and acquisition experiences. Access to this real-time information, in contrast with the aged data relied upon by others, ensures clients of more reliable valuations, which is crucial when financial and strategic decisions are being made.



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