HYMANS ROBERTSON LLP

Brookfield Timberland Opportunity

Addressee

This paper is addressed to the Officers of Suffolk County Council as administering authority for the Suffolk County Council Pension Fund ("the Fund"). It relates to an opportunity to obtain a co-investment in timberland with Brookfield, the timberland manager that the Pension Committee appointed in 2012 to manage their timberland mandate.

Background

In 2012, Suffolk County Council committed £30 million (2% of assets at the Fund's prevailing value) to Brookfield's Timberland Fund V, a closed ended fund that will invest in timberland on a global basis. The funding for this investment will be drawn down gradually over 2-3 years. In late January, Brookfield approached the Fund with a proposal to invest in a single timberland investment, based in the North West of the United States. This investment opportunity, which amounts to US$200 million in total, is being offered in the first instance to investors who have committed to invest, like the Suffolk Fund, to Brookfield Timberland V. Brookfield will open this offer to other investors only if the Timberland V investors do not take up the full US$200 million amount.

The offer

The underlying investment proposed is an integrated forestry operation called Longview Timber, located in Oregon and Washington states. There are a number of distinct forests as well as downstream operations (i.e. sawmills and distribution). The forests are relatively mature. Brookfield expressed this as having too much inventory, i.e. felling was delayed when demand was lower. However, demand has picked up. The manager will be over-felling to meet demand, while at the same time reducing inventory.

The Fund knows Brookfield as a manager of timberland assets. In fact, Brookfield is an investment corporation which specialises in real assets (property, agriculture and timberland); it operates both as an owner of these types of assets on its own behalf, and as a manager for others. It has an investment management division which manages these categories of assets for external investors, both on a segregated basis (for very large institutions) and in pooled funds.

Brookfield currently controls approximately 68% of Longview, either directly, or within funds they manage for other investors. The other 32% is held by "Europe's largest pension fund". Brookfield is selling a $200 million stake, which is currently part of their proprietary holding. In the first instance, this is being offered to investors who signed up as Fund V limited partners, so Brookfield will continue to have 68% control. Brookfield has owned its stake since 2007. The combined Longview operation is contained within a single timberland REIT (real estate investment trust).

Last year, Brookfield was approached by a prospective bidder. Rather than accept this offer, they put the entire stake out for auction to test the market appetite; their guide price was US$2.75bn. The REIT has $1.07 billion of debt. The strongest bid received was $2.65 billion, some 4% below their target price. They also obtained the report of an independent valuer (a highly regarded specialist valuer of timberland assets), which confirmed the guide price. As a result of the valuer's report, they determined that there was greater value in retaining the investment. The bidding process they conducted and the valuer's report are consistent; the bid they received supports the valuer's assessment as a fair appraisal.

We are in the process of gaining access to additional information including the lengthy valuer's report.

Location

This is premium territory for timberland. The properties are spread over the states of Oregon (Columbia River, Willamette valley) and Washington (Puget Sound). There are two main timberland zones in these states. Trees closest to the Pacific are not part of Longview and are mainly hemlock. The Longview properties are bit further inland (which is a better growing climate) and lie between the Pacific coast and the Cascade mountain chain (the northern part of the Pacific ridge). The trees are mainly Douglas fir (with some hemlock); they are typically 130 feet high and 12-18 inches diameter with few branches at the lower level. The stems are very clean and straight. The lower parts of the trees are knot-free, which means they can be used for high quality (and high value) situations (e.g. specialist veneers). The girth means the trees can be sawn into bigger posts (greater breadth and width) so they can be used as load-bearing posts; this again makes the trees more valuable.

Several other timberland managers and Weyerhaeuser (a US quoted forestry products company) own timberland assets in the same area.

Category

This forest is relatively mature; indeed Brookfield believes it is over-inventoried, so they will be "over-felling" in the next 5 years. This means that a much of the return expected (an internal rate of return of 10% p.a.) would come from yield (cash yield of 9%). This also means that the impact of FIRPTA (Foreign Investment in Real Property Tax), a tax that applies to non-US investors will be low because the tax is based on capital gain and not income. Brookfield estimate that the tax impact would be 10%; they estimate this is what US investors suffer, so this also appears a tax efficient investment in forestry for non-US investors. Further, the investment is held in a speciality REIT structure (exclusive for this asset), which is tax efficient. This specific co-investment opportunity (the US$200 million offer) will be held in a limited partner structure, managed by Brookfield on behalf of investors.

Demand profile

There are two principal customer bases. The prime export markets are Japan, China and Korea. The timberlands are close to the main Pacific ports for these areas. The US markets are principally west coast, including California (as well as Washington, Oregon). Demand is improving in both areas, particularly in the US, where the growing population (and a sharp fall in house prices) means that the housing market has started to recover relatively strongly. This is the reason why Brookfield will be over-felling in the next few years.

Particular attractions of Longview

This co-investment is attractive, because the Fund will invest into timberland more quickly and the investment will begin to deliver yield quickly. The fee structure is low at 0.6% p.a. with no performance element. Brookfield expect to have investors signed up relatively quickly, with the close on the US$200 million offer by end April. Initially, this is only being offered to Fund V investors (like Suffolk).

Suffolk's existing commitment

Suffolk have committed to Fund V, which will go to fourth close at end February. They expect final close by April 2013. Fund V would allow any single investment to be up to 40% of the aggregate fund. They said that, if they were to look at Longview as a standalone opportunity, it would be a target for Fund V at this maximum 40% weight, because they think Longview is particularly attractive. However, Brookfield already have a major stake in the asset; they will not consider Longview for Fund V, so an investor in Fund V such as Suffolk need not be concerned about investment concentration risk if they participate in Longview

Conflict of interest

Brookfield is on both sides of this offer. It currently owns the US$200 million stake it is offering to investors and will then manage the assets (for a fee) on behalf of those investors. This is a potential conflict. Nevertheless, Brookfield is in the first instance targeting Fund V investors, many of whom will be new to timberland or to Brookfield. We consider it unlikely that Brookfield would seek to begin a relationship with an offer that was unsuitable for new clients. Further, the fee proposal is attractive.

Conclusion and recommendation

We believe this is a very attractive opportunity, particularly because of the asset quality and the high cash yield. This will also enable the Fund to gain earlier exposure to timberland. We recognise potential conflicts of interest because Brookfield is reducing its own stake. However, for the reasons given above, we are satisfied that the proposed price is likely to be fair to both parties.

The Fund agreed last year to commit £30 million to Brookfield Fund V. At the time, that represented 2% of Fund assets. The Fund value has grown since, so that 2% would now represent nearer £33 million. Further, the Fund value is likely to grow over the period of time when Fund V will be drawn down. We believe there is scope for the Committee to make an additional investment in Timberland. This is partly influenced by the particular qualities of this co-investment proposal. We are still conducting due diligence on the proposal.

We recommend that the Committee give provisional agreement (subject to satisfactory due diligence) to make a commitment of £8 million (approximately US$12.5 million) to this Brookfield co-investment - Longview. This would mean that Longview would account for approximately 0.5% of Fund assets, that it would make up approximately 20% of the Fund's allocation to timberland and that the aggregate allocation would be approximately 2½% of Fund assets (when fully committed).

We will be pleased to answer any questions about this at the forthcoming meeting.

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Prepared by:-

John Hastings, Partner

For and on behalf of Hymans Robertson LLP

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Risk Warning

Please note the value of investments, and income from them, may fall as well as rise. This includes equities, government or corporate bonds, and property, whether held directly or in a pooled or collective investment vehicle. Further, investments in developing or emerging markets may be more volatile and less marketable than in mature markets. Exchange rates may also affect the value of an overseas investment. As a result, an investor may not get back the amount originally invested. Past performance is not necessarily a guide to future performance.