LUMBER

CURRENT TRENDS

- Due to increased demand for renovation and repair prompted by the COVID-19 pandemic and the strong housing market, pricing for lumber and panel products has increased across the board.
- Privately-owned housing starts for July were up 23.4% over July 2019 and have fully recovered from the pandemic periods in April and May.
- Industry capacity utilization remains below normal, as capacity cutbacks enacted in March in relation to the coronavirus pandemic and difficulties in managing production in the face of social distancing measures have lowered available supply.
- Trade policy and tariff levels have not changed significantly since 2019 and are having an ongoing impact on lumber and log volumes in several markets.

PROJECTED VALUES
(12-MONTH OUTLOOK)

DECREASING STABLE INCREASING

APPROXIMATE NET RECOVERY ON COST

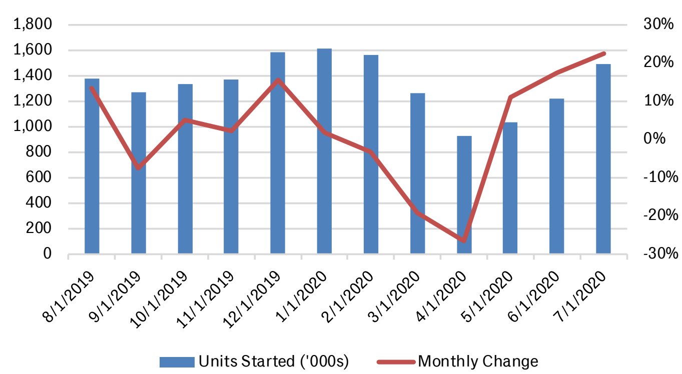
80-90%

kiln dried and dressed lumber and panels (mill and wholesale distributor)

50-70%

logs

NEW PRIVATELY-OWNED HOUSING STARTS
(SEASONALLY ADJUSTED)



REFERENCE SOURCES: RANDOM LENGTHS WEEKLY REPORT, UNITED STATES CENSUS BUREAU, CNBC, FEDERAL RESERVE ECONOMIC DATA, HARDWOOD MARKET REPORT, BOISE CASCADE, THE NEW YORK TIMES

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GORDONBROTHERS.COM
+1.617.426.3233

HOUSING STARTS STRONG: Domestic housing starts are useful in monitoring the health of the construction industry and the demand for dimensional lumber. For July, new, privately owned housing starts in the United States were at a seasonally adjusted annual rate of 1,496,000 units. This represents a strong increase of 23.4 percent over the July 2019 rate of 1,212,000 units, and a very strong rebound after the housing market was on pause during April and May. In these months, social distancing measures and essential business closures were at a peak.

The market is benefiting from three key trends at this time: (1) the pandemic is improving the demand for single-family residential construction as homeowners consider a transition to less densely populated geographies; (2) with homeowners spending more time at home, repair and remodel spending continues to strengthen as homeowners invest in existing homes; (3) housing supply has fallen due to the lingering impact of the Great Recession as well as demographic changes. While the key trends #1 and #2 are due to COVID-19 and may abate in 2021 with vaccine availability, trend #3 is a longer-term trend and a positive factor in the market. In addition, the current lower interest rate environment should support a higher level of investment in housing.

LUMBER PRICING VOLATILITY: Largely due to the COVID-19 pandemic, pricing for softwood lumber and panels has shot up due to a shortage of supply and robust demand—particularly in the home center market. The Random Lengths? Framing Lumber Composite Price index dropped in early April, as a significant number of mills were either shut down or had enacted production reductions. These curtailments were reported at over 15 companies across Canada and the U.S. and affected a high multiple of mill operations. Many of these shutdowns or production reductions were initially scheduled to end after two to three weeks; however, most of these slowdowns were extended through May or later. In March, American timberland company Weyerhaeuser Co. announced it would initiate a 20-percent cutback on lumber production, a 15-percent reduction in oriented strand board, and a 15- to 25-percent reduction in engineered wood products.

Four facilities were indefinitely or permanently curtailed (one, Klausner Mills in Enfield, North Carolina, due to bankruptcy) in April. Forest products data firm RISI estimated that 30 percent of the industry was curtailed in some form in April. Most mills that were shut down reopened in May due to tight market conditions and higher than expected demand, but then ran at reduced capacity due to new operating procedures related to COVID-19. In a June 30 press release, wood manufacturer Boise Cascade Co. reported, "As we begin the third quarter, Wood Products is in the process of attempting to restore production rates to pre-COVID-19 levels in response to strong end-product demand. However, we continue to experience periodic short-term disruptions at many locations due to COVID-19. In addition, we expect activity levels across our distribution network to continue to vary widely as COVID-19 impacts geographies across the U.S. to differing degrees, and federal, state, or local restrictions are implemented or rescinded."

The U.S. Federal Reserve Board reported that as of July, the wood products industry was running at a capacity utilization of 70.6 percent, which was well above April's level of 64.2 percent, but below the 76.9 percent seen in February, and off from the July 2019 level of 77.4 percent. As a result of the capacity issues as well as the robust demand, prices have been rising since April for most grades of lumber and structural panels. As of August 21, the Random Lengths Framing Lumber Composite Index was at a reading of $817, which was 134.1 percent higher than 12 months prior. Considering that pricing plummeted to a 2020 low in early April, the rate of the price increase has been historic, with traders saying that they have not seen a rise "comparable to the current one in their careers." The index began the year at $375 and declined to $348 by April 10, before recovering.

Lenders should keep in mind that industry publications can indicate regional market trends, but published prices are not necessarily representative of transactional activity. Prices generally represent full truckload quantities with free-on-board mill freight terms. Long-term supplier relationships, volume discounts and freight logistics can impact the actual gross recoveries in the event of an orderly liquidation.

LUMBER TARIFFS REMAIN RELATIVELY UNCHANGED: The China tariff situation remains broadly unchanged from 2019, with a June 2018 Chinese tariff still limiting U.S. hardwood exports to China. While there was an expectation that the Phase I deal reached in early 2020 would result in reduced Chinese tariffs on U.S. hardwoods. This did not occur, and a Phase II deal—which was expected to be negotiated at some point in 2020—has not materialized and negotiations have not started. While hardwoods account for 14.7 percent of the timber market, pricing in this segment has been hurt by the drop in exports to China; exports declined 44.4 percent in 2019, after a 25-percent tariff was levied in June of 2018. Recently, final anti-dumping tariffs were applied against Chinese manufactured moldings and millwork at rates varying from 40.3 to 359.2 percent.

Tariffs enacted in 2017 against Canadian softwood lumber imports remain largely in place and unaffected by the passage of the United States-Mexico-Canada Agreement (USMCA), which went into effect on July 1, 2020. Additionally, a longstanding U.S./Canadian dispute before the World Trade Organization over tariffs on Canadian softwood lumber was largely decided in Canada's favor on August 24, 2020. Per *New York Times* reporting, "A three-person panel determined that the duties, designed to counter Canadian subsidies, breached global trading rules because Washington had not shown that many prices paid by Canadian firms for timber on government-owned lands were artificially low."

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The Expert: Alex Sutton

Alex Sutton is Managing Director and Head of Research for Gordon Brothers' Valuation division where he coordinates industry guidance and market research to support cross-asset appraisals. With over two decades of experience, Alex has directed inventory appraisals across a range of industries, including aerospace, agriculture, metals, pharmaceuticals, and plastics. Read his full bio here

Gordon Brothers 1903
GORDONBROTHERS.COM
+1.617.426.3233