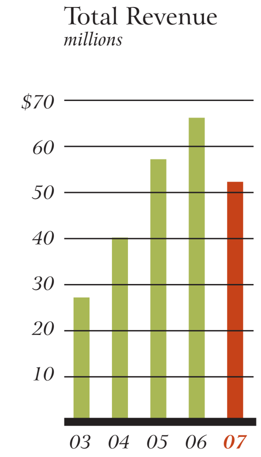
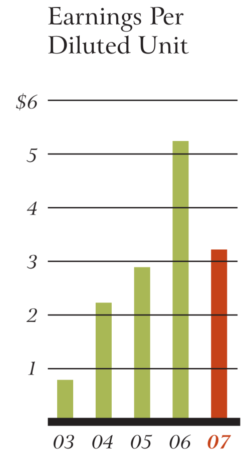
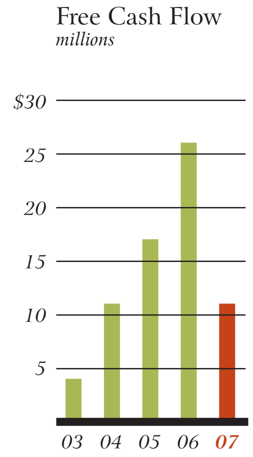
POPE RESOURCES | 2007 ANNUAL REPORT

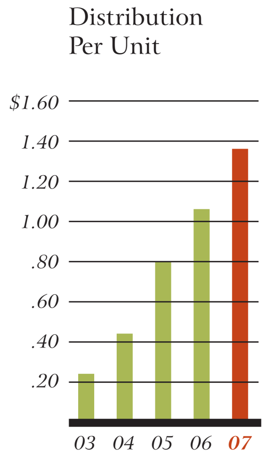
FINANCIAL HIGHLIGHTS

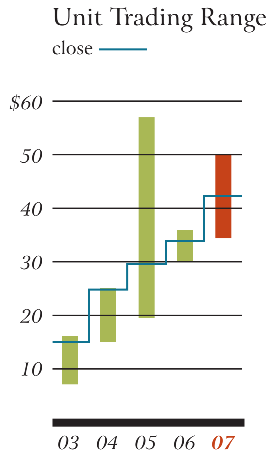
(Thousands, except per unit data)	***2007***	*2006*	*2005*
Revenue			
Fee Timber	$35,514	$35,260	$44,424
Timberland Management & Consulting	1,344	3,670	7,764
Real Estate	15,037	27,320	4,818
Total revenue	$51,895	$66,250	$57,006
Income/(loss) from operations			
Fee Timber	$15,215	$14,592	$16,320
Timberland Management & Consulting	(883)	1,266	3,540
Real Estate	5,163	13,864	1,270
Administrative	(4,782)	(3,817)	(3,651)
Total income from operations	$14,713	$25,905	$17,479
Net income	$15,508	$24,910	$13,684
Net income per fully diluted unit	$3.21	$5.23	$2.88
Free cash flow	$11,268	$26,080	$16,731
Free cash flow per fully diluted unit	$2.34	$5.48	$3.52
Unit price at year-end	$42.75	$34.32	$31.02
Distribution per unit	$1.36	$1.06	$0.80
Units outstanding at year-end	4,663	4,647	4,627
Total assets	$179,325	$180,282	$106,358
Long-term debt, including current portion	30,727	32,208	33,883
Minority interest – IPMB	3	77	325
Minority interest – ORM Timber Fund I, LP	45,803	46,685	0
Partners' capital	96,644	87,605	66,405
Partners' capital per unit	$20.73	$18.85	$14.35
Fee timber harvest (MMBF)	55.1	54.5	74.2

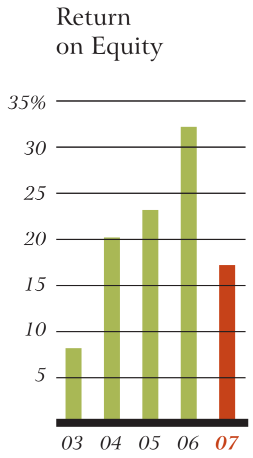

Total Revenue
millions
$70
60
50
40
30
20
10
03 04 05 06 07


Earnings Per
Diluted Unit
$6
5
4
3
2
1
03 04 05 06 07


Free Cash Flow
millions
$30
25
20
15
10
5
03 04 05 06 07


Distribution
Per Unit
$1.60
1.40
1.20
1.00
.80
.60
.40
.20
03 04 05 06 07


Unit Trading Range
close
$60
50
40
30
20
10
03 04 05 06 07


Return
on Equity
35%
30
25
20
15
10
5
03 04 05 06 07

DAVID L. NUNES
President and Chief Executive Officer

VISION:

Our objective is to be the premier timber and land investment team in the Pacific Northwest.

MISSION:

We create value by owning and managing timberland and real estate.

DEAR FELLOW UNITHOLDERS,

In last year's letter, I had the pleasure of trumpeting 2006 as a record year. That set up a tough act to follow, and we knew going into 2007 that we were heading into softening log and real estate markets. That said, I am happy to report that results for 2007 represent the second strongest year, from an earnings standpoint, in our history, with net income of $15.5 million, or $3.21 per diluted unit, on revenue of $52 million. This compares to 2006, when we had net income of $24.9 million, or $5.23 per diluted unit, on revenue of $66 million.

As with 2006, much of our success in 2007 was a function of capturing values from sales in our Real Estate segment, where we have been investing time and money over a number of years to add value to our properties. In 2007, we completed the $7.2 million sale of five retail building pads totaling six acres on the Costco shopping center site in our Gig Harbor project, representing a record sale of $1.2 million per acre.

Given the slowdown in new housing starts both locally and nationwide, however, and the ripple effect back to lumber, log, and raw land prices, we clearly recognize that 2008 will be a tough year for our Fee Timber and Real Estate segments. As such, it will likely be the most challenging year Pope Resources' current management team has yet faced. Nonetheless, we are confident that we are in a strong position to weather the tough markets that 2008 is expected to bring.

We previously announced plans to reduce our 2008 log harvest volume, which includes the consolidated results of ORM Timber Fund I, LP, by 36% from our long-term sustainable level of 57 million board feet (MMBF) and 33% from our 2007 harvest of 55 MMBF. This decision represents a marked departure from business as usual and it will significantly affect our short-term financial results. This tactical response was based on anticipated weak markets in 2008 and took into account our expectation of when markets will recover. Our focus on creating long-term unitholder value and our strong balance sheet affords us the ability to "bank" value on-the-stump and allow both biological growth and log market appreciation to add value to our timberland portfolio.

Capital Allocation – Past, Present, and Future

Relative to earlier years in our history, Pope Resources is in the enviable position of having considerable capital at its disposal. Excluding capital used to acquire timberlands either outright or through our Timber

Fund in the form of a co-investment, we have generated $65 million of free cash flow over the four years from 2004 to 2007. This compares to a cumulative free cash flow generation of $30 million for the preceding 10-year period from 1994 to 2003. As highlighted below, this growth in free cash flow has afforded us the luxury of simultaneously growing our asset base and returning more capital to unitholders in the form of higher distributions and a unit repurchase program.

- During these past four years, we've spent $33 million to effectively add approximately 9,500 acres of timberlands to our portfolio (at an average value of approximately $3,466 per acre). This consisted of 4,700 acres in 2004 in two small transactions and another 4,800 acres as represented by our 20% interest in our first private equity timber fund, ORM Timber Fund I, LP, which acquired 24,000 acres in 2006.
- We've grown our quarterly unit distribution in each of the last six years, from when it was reinstated at $0.05 per unit in the third quarter of 2002 to our current quarterly distribution of $0.40 per unit. On an annual basis, this has translated to an increase from $0.5 million paid out in 2002 to $6.4 million in 2007.
- Based on a steady increase in our trading volume and our Board's view that purchasing our own units represented one of the best alternatives for investing our capital, we decided in November to launch an open market buyback program. In a little over four months, we've bought back approximately 120,000 units, or roughly 2.5% of the total units outstanding as of the beginning of the repurchase program and 94% of our $5 million program goal.

On a going-forward basis, we recognize the importance, especially in light of current soft market conditions for our core log and real estate markets, to have a clearly defined capital allocation philosophy. We've worked hard to strengthen our balance sheet and don't want to put ourselves in a vulnerable position by either spending our cash too quickly or imprudently, or by taking on too much debt.

A key objective of our capital allocation philosophy is to add to our timberland holdings, with co-investment in our timber funds as the primary avenue for participating regularly in the timberland acquisition market. In 2007, we completed the first full year of operation for our Timber Fund, which in late 2006 acquired 24,000 acres of timberland for $58 million. Pope Resources is a 20% investor alongside other third-party investors, allowing us to deploy nearly $12 million of co-investment capital. Going forward, roughly $20 million of future capital is earmarked for co-investing in ORM Timber Fund II, a $100 million private equity fund focused on acquiring timberland in the U.S. West. We expect to close this fund in the first half of 2008 and to invest the capital over a two-year period.

Over the past two years, our 2,600-acre Real Estate portfolio has contributed $42 million in revenue, primarily from Gig Harbor and Bremerton, where our properties with the highest per-acre values are located. However, to produce such returns, we invested $25 million of capital into our projects over the past four years. We need to continue to invest capital in these projects to enable future "harvests", especially in light of the long lead times needed to secure entitlements and develop the necessary infrastructure to create a pipeline of properties to bring to market. While the real estate market has cooled of late, our Real Estate investments, which have translated to a growth in this segment's book value to $22 million by the end of 2007, should help to create a foundation for future strong sales as our projects reach maturity over the balance of this decade and beyond.

In addition, we plan to return capital to our unitholders, in the form of our quarterly distribution, at a level that is competitive with other publicly traded equities focusing on timber. We are pleased to have been able to increase our quarterly distribution to a level where it is competitive, on a yield basis, with our peer companies. While we recognize that we earned substantially more than we distributed to unitholders over the past few years, we also realize that with our reduced harvest in 2008, our distribution will exceed our earnings this next year. Once markets recover and we resume harvesting at our long-term sustainable level, we anticipate again earning more than we distribute.

An alternate use for our current cash balance might otherwise be to pay down our $31 million of total debt. We are hampered, however, in acting on that impulse because our timber mortgages, which have terms that last until 2011, have interest rate make-whole provisions that translate into a prepayment penalty that effectively prevents us from paying down the principal balance ahead of schedule.

Between our cash, short-term investments, expected near-term cash flow, and access to credit markets, we believe we have adequate capital to grow our timberland base through co-investment in our timber funds, continue investing in our real estate projects, and return capital to our unitholders through quarterly distributions and unit repurchases. However, to the extent log and real estate markets remain soft for a protracted period of time, we may be forced to reduce our distributions, suspend any ongoing unit repurchases, establish a line of credit, or increase our secured borrowings to continue making these investments. Should this need arise, we are confident in our ability to add incremental debt without putting our strong balance sheet at risk. As of the end of 2007, we enjoyed a 24% total-debt to total-capitalization ratio, as measured by the book value of our assets (13% when using the market value of our equity), which affords significant borrowing capacity if necessary.

Prospects for Our Business Segments Going Forward

Notwithstanding the strong performance we've enjoyed the past few years from the perspective of net income and cash flow generation, we recognize we're heading into very difficult market conditions. We do not pretend to know how long these current market conditions will prevail, but nonetheless believe we are well positioned to weather any potential sustained downturn based upon the strength of our balance sheet, the experience of our management team, and our strategies for creating long-term unitholder value. This confidence stems from the following positioning we see for each of our key business segments, each of which I will address in more detail:

- the general attractiveness, from an investment perspective, of our core Fee Timber portfolio;
- the ability of our management team to generate a long-term source of fee income by applying its

expertise to adding value to third-party portfolios of timberlands;

- capturing non-timber values from our Fee Timber and Real Estate portfolios based on their proximity relative to growing populations in Puget Sound; and
- the existing pipeline of lands in our Real Estate portfolio and our demonstrated ability to add value to these projects.

TIMBER AS AN INVESTMENT ASSET CLASS. In spite of weak current log market conditions for our core Fee Timber segment, brought about by being in a low point in the housing cycle, we remain bullish on the long-term prospects for this business. This belief is based in part on the long-term economic drivers for forest products, which key off growth rates in population and wealth. As world economies grow in size and/or in per capita wealth, they use more forest products, which provide a strong basis to support current as well as future investments in timberland.

Our properties are located in highly productive timberland growing areas west of the Cascade mountain range in Washington and feed a variety of mills in Washington and Oregon, the nation's top two producing lumber states. Forest products from this region, in addition to serving local needs, are competitively situated to serve markets throughout the western United States as well as Asian markets in Japan, Korea, and China. The productivity of our lands has further benefited from the application of advanced silvicultural techniques and the use of proprietary seed sources used to grow new generations of seedlings.

Over the long term, the timber asset class has delivered compelling risk-adjusted returns with attractive diversification attributes. Investment managers have discovered the return and diversification benefits of adding timberland to their portfolios, resulting in an explosive growth rate of institutional ownership of timberland over the past 20 years. Investors who are interested in adding timberland to their investment portfolios, but do not have the capacity or inclination to invest in the asset class directly, can buy stock in companies that own timberland. The choices available include buying stock in integrated forest product companies or single-level tax pass-through vehicles such as Pope Resources that specialize in timberland ownership.

By virtue of our publicly traded partnership governance structure, our unitholders enjoy the financial benefits of owning timberland in a tax-efficient vehicle. For a pass-through entity such as Pope Resources, profits associated with timber harvesting are treated as capital gains income, taxable today at 15%, while all other costs associated with managing the lands and the partnership are treated as ordinary expense and thus taxed at a unitholder's higher marginal tax rate. Since most of Pope Resources' revenue comes from log harvests, we generate an ordinary loss to go against the capital gain from log harvest income. Even though the bottom line may indicate a profit, the interplay between the two tax rates can create a net tax benefit. This benefit, or "tax yield", is different for each unitholder based on when their units were purchased and may vary considerably in years when we have meaningful real estate revenue, but is nonetheless advantageous relative to other forms of timberland ownership. When factoring in our quarterly distribution, which is a tax-free return of capital, the total after-tax yield for our unitholders is quite competitive with other publicly traded timberland-owning vehicles such as REITs.

ADDING VALUE THROUGH OUR THIRD-PARTY TIMBERLAND MANAGEMENT SERVICES. Since 1997 when we established the Olympic Resource Management ("ORM") brand as a means of providing third-party services, we have managed more than 1.5 million acres across western North America and have established a reputation as one of the premier third-party timberland managers in the western United States. Notwithstanding a turn toward modest results in recent years, the positive impact to date of this business initiative is evidenced in the $65 million of third-party service fee revenue generated over the past decade that has in turn allowed us to attract outstanding talent that neither our own assets nor those of our clients could justify alone. Competing in third-party markets, whether for investors for our timber funds or land management contracts, has also had the added benefit of energizing our culture and keeping our focus on a broad array of opportunities outside our local geography. We continue to explore other opportunities to build on this platform of management success and extend the ORM brand.

As described earlier, one of our key strategies going forward is to grow our private equity timber fund business by raising outside investor capital and combining it with our own capital in the form of co-investment in our funds. Over time, as we are able to grow the size of this business, our unitholders will not only benefit from the cash flows associated with our co-investment, but will also enjoy increased economies of scale, fee income from managing both the properties and the funds, and future carried interest participation fees if a particular fund delivers returns to investors above a pre-determined threshold. We don't expect to get there overnight, but believe we can build a portfolio of funds over time that will benefit our third-party investors and Pope Resources' unitholders for many years to come.

CAPTURING NON-TIMBER VALUES FROM OUR WEST PUGET SOUND PROPERTIES. In recent years, non-timber values have played an increasingly important role in the financial performance of timberland portfolios. The most meaningful of these other values relates to the potential for converting the land to higher-and-better-use (HBU) real estate. As in traditional residential real estate markets, the potential for HBU value is driven largely by the location of the property. As seen on the satellite map on the next page, which overlays Pope Resources' ownership against the backdrop of the Seattle-Tacoma metropolitan area and other communities in west Puget Sound, we have a lot of property located within a 30-mile radius of this growing metropolitan area. This map includes most of our 70,000-acre Hood Canal tree farm and our 2,600-acre Real Estate portfolio. We are working to maximize the value of our properties in this geography and over the coming decades expect to gradually reduce our footprint in the west Puget Sound region. Factors that limit the ability to shift this land to HBU real estate include existing zoning regulations and the rate at which the market can absorb new properties for sale.


Lands owned by Pope Resources
Washington State Ferry Route
Port Gamble
Quilcene
Edmonds
Kingston
Poulsbo
Puget Sound
Hood Canal
Silverdale
BAINBRIDGE ISLAND
Lake Washington
Redmond
SEATTLE
Bellevue
Bremerton

Other non-timber revenue streams include mineral leases for natural gas, gravel, and rock quarries; leases for cellular telephone towers, collecting boughs and other ground cover; and road-use easements. In 2007, Pope Resources realized more than $2 million in revenue from these alternative sources of revenue. The largest single component of this non-timber revenue was from gravel sales, which are also peripherally related to the proximity of our lands to a growing population base. While still in the early stages of development, other emerging non-timber revenue sources with possible future economic benefit include monetization of conservation easements, carbon credits, and biofuels.

REAL ESTATE PIPELINE AND TRACK RECORD. For most timberland portfolios, HBU activity consists of carving off discrete parcels of land and, subject to underlying zoning regulations, selling it as rural residential building lots. These sales are typically for values well in excess of the corresponding timberland value, but are limited by market absorption. While approximately 75% of our Real Estate portfolio, with zoning for 5- to 80-acre lots, fits into this category of rural HBU properties, this is not the most valuable portion of our portfolio.

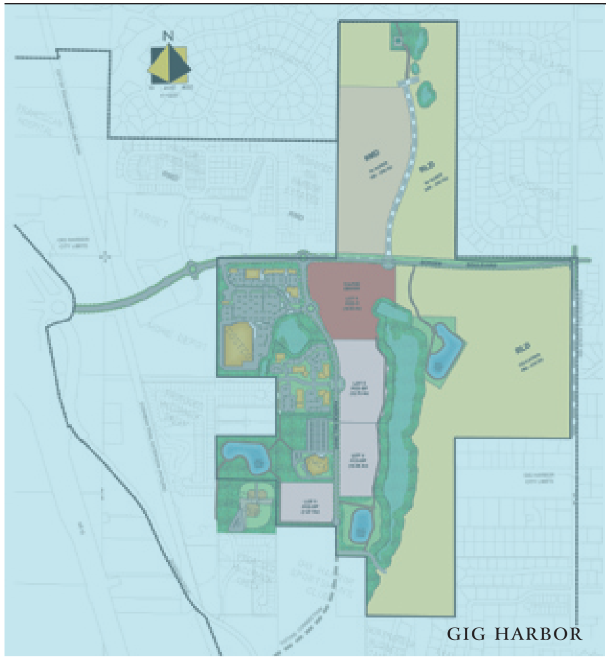
The remaining 25% of our portfolio lies within urban growth boundaries as defined by Washington state's Growth Management Act (GMA). The GMA, which was designed to prevent suburban sprawl, greatly increased residential densities for lands located within urban growth boundaries. The partnership worked hard in the early years following the passage of the GMA to get as much of our property as possible located within these urban growth boundaries. Our projects in Gig Harbor, Bremerton, and Kingston all enjoy the higher density residential zoning associated with this GMA classification.

Our Real Estate efforts focus in large part on early stage entitlement activities, such as securing favorable zoning and obtaining final plat approvals that make downstream development possible. Where appropriate, our efforts also include road building and the extension of utilities to increase the value of building lots. The results of this work, which have started to flow through our income statement in the past few years, is a pipeline of valuable residential, business park, and commercial parcels located within these urban growth areas.

Our Gig Harbor project, consisting of 251 acres following sales in 2006 and 2007 as well as transfers of roads and open space, consists of a mix of 16 acres of commercial property, 32 acres of business park land, and 203 acres of residential land that ultimately can support 800 to 1,000 residential lots. The entitlements needed to begin marketing the residential portion of this project are still a few years off, but our hope is that by the time this entitlement effort is complete, the residential real estate market will have improved from its current state. We are currently marketing portions of the business park land and view this and the commercial land as "amenities" to the downstream residential portion of the project. For example, we believe the Costco shopping center and the new YMCA located on our project together serve as an attractive draw to potential customers of residential lots.

The Bremerton project, originally a 264-acre mixed use project, is nearing its final phase. We sold the 200-acre residential portion of the project in 2006, recognizing a portion of the revenue in each of 2006 and 2007. We completed infrastructure investments on the first phase of the 64-acre industrial park land and closed on two of 24 total industrial lots during 2007. Following sufficient absorption of the remaining Phase I lots, we will complete the infrastructure investments on Phase II of the industrial park land and begin to market the balance of the 24 lots.

We made much progress on our 356-acre Kingston project in 2007, following successful inclusion of this project into the Kingston urban growth area in 2005 and a lengthy appeal process that concluded in 2006.



GIG HARBOR PROJECT:
HARBOR HILL

Commercial zoning:

- *Costco opened Nov. 2007*
- *Pad sale that closed Dec. 2006 under construction*
- *16 acres remaining*

Business Park zoning:

- *YMCA opened July 2007*
- *6-acre church sale closed Dec. 2007*
- *32 acres remaining*

Residential zoning:

- *173 acres at 4 units/acre*
- *30 acres at 8 units/acre*
- *Estimated total yield of 800 to 1,000 units, based on topography*

KINGSTON PROJECT:
ARBORWOOD

- *Project totals 356 acres located 1 mile from Kingston ferry terminal*
- *Incorporated into urban growth area in 2005*
- *Master plan submitted in Dec. 2007 for 751 lots, including preliminary plat on the first two development phases totaling 245 residential lots*
- *Ownership includes neighboring 366 acres with 5-acre zoning, subject to county option to expand regional heritage park*

In 2007, we submitted a master plan for the entire 751-lot project, as well as the preliminary plat on the first two development phases totaling 245 residential lots. Once the preliminary plat approval is secured, we will commence with marketing residential lots to various home builders. We also completed construction in 2007 of a 19-lot residential development in nearby Hansville totaling 152 acres.

The entitlement and related infrastructure construction activities performed by our Real Estate professionals are by nature long lead-time activities. Our intent is to stay focused on adding value to the land and then at the right time selling either bulk land or finished lots to downstream builders or end-use customers. We believe our long-term focus paid off during this past real estate business cycle as we were able to capitalize on strong market conditions with completed lot inventory ready to sell. It is our intent to continue to focus on the long term by investing in our projects and being in a position to "restock" the pipeline of Real Estate properties ready to sell as we reach the next peak in the real estate business cycle.

Liquidity and the Impact on Unit Valuation

By any relative measure, average trading volumes for our partnership units are very low. It is our view that this has a significant impact on the market valuation of our units, which is compounded by our small size relative to other timber owning public companies, a limited float due to large blocks of ownership, our limited partnership governance structure, no analyst coverage, and a lack of other publicly traded partnerships focused on timber.

Our approach to addressing this limited liquidity has been to focus on the transparency of our investor communications. Ultimately, our goal is to combine strong operating performance with highly transparent investor communications so as to develop more widespread interest in owning our units and increase our trading volume. We believe these efforts are beginning to pay off, as we have seen an increase in the number of institutional owners, additional market makers, lower bid-ask spreads, a higher number of daily trades, and increasing trading volume. In the five-year period from 2000 to 2004, our average non-block trading volume was 322,000 units per year. In the ensuing three-year period from 2005 to 2007, this trading volume more than tripled to an average of almost 1.1 million units per year. While we are still thinly traded compared to our peers, we are nonetheless encouraged by this improvement in the liquidity of our units.

We also believe that the liquidity for our units has improved, in part, as a result of our financial performance over the past few years, the increase in our unit distribution level, which now stands at $0.40 per quarter, representing a yield of just over 4%, and our recent unit repurchase program. Whether a function of our strong financial performance or improved trading liquidity, or both, our unitholders have enjoyed returns over the past five years that exceed the performance of all our public company timber-owning peers. From a total unitholder return perspective, where reinvestment of distributions is included, our unitholders have enjoyed a five-year compound annual growth rate of 36.9% per year.

What We Expect in the Next Couple of Years

As pleased as we are about our performance over the last number of years, we recognize we are operating in a very challenging environment as the cyclical markets so closely aligned with our business work through low points. While we expect significantly lower earnings in 2008, we are well positioned to weather a sustained downturn and our focus remains on building long-term unitholder value. When the recovery in housing and real estate markets occurs, we want to be prepared to capitalize on it by having land and timber ready to sell. We're "investing" in our Fee Timber segment by deferring harvest and leaving the timber to grow in value and volume; we're "investing" in our Real Estate segment by replenishing our pipeline of properties ready to sell; and we're "investing" in our timber fund business by placing our free cash flow alongside outside investor capital to grow future cash flows. Over time, as we operate our Fee Timber assets and "harvest" the value of our Real Estate portfolio, we expect to be able to both increase the amount of capital returned to unitholders and grow the size of our timberland holdings.

One of the benefits of being a small company with only a limited following is that the market doesn't focus on swings in quarterly earnings and doesn't have well-defined annual earnings expectations. This affords us the ability to truly focus on creating long-term value for our unitholders. The challenges ahead for the near-term will test our vision and the discipline of our approach, but I am confident that our segment strategies will succeed in the long term. This optimism is due in no small part to the top-flight team of employees at Pope Resources that are dedicated to realizing an exciting vision for this company. It is a privilege to lead such an outstanding group of people and we thank you, our unitholders, for your continued support of our vision, strategies, and team.

DAVID L. NUNES
President and Chief Executive Officer
March 15, 2008

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This report contains a number of projections and statements about our expected financial condition, operating results, and business plans and objectives. These statements reflect management's estimates based upon our current goals, in light of management's knowledge of existing circumstances and expectations about future developments. Statements about expectations and future performance are "forward looking statements" which describe our goals, objectives and anticipated performance. These statements are inherently uncertain, and some or all of these statements may not come to pass. Accordingly, you should not interpret these statements as promises that we will perform at a given level or that we will take any or all of the actions we currently expect to take. Our future actions, as well as our actual performance, will vary from our current expectations, and under various circumstances these variations may be material and adverse. Some of the factors that may cause our actual operating results and financial condition to fall short of our expectations are set forth in the part of this report entitled "Risk Factors". Other issues that may have an adverse and material impact on our business, operating results and financial condition include environmental and land use regulations that limit our ability to harvest timber and develop property and economic conditions that affect consumer demand for our products and the prices we receive for them, and other risks and uncertainties which are discussed in our other filings with the Securities and Exchange Commission. The forward-looking statements in this report reflect our estimates as of the date of the report, and we cannot undertake to update these statements as our business operations and environment change.

This discussion should be read in conjunction with the Partnership's audited consolidated financial statements included with this report.

EXECUTIVE OVERVIEW

Pope Resources, A Delaware Limited Partnership ("we" or the "Partnership"), was organized in late 1985 as a result of a spin-off by Pope & Talbot, Inc. ("P&T"). We are engaged in three primary businesses. The first, and by far most significant segment in terms of owned assets and operations, is the Fee Timber segment. This segment includes timberlands owned directly by the Partnership and operations of ORM Timber Fund I, LP (the "Fund"). Operations in this segment consist of growing timber to be harvested as logs for sale to domestic and to a lesser extent export manufacturers. The second most significant business in terms of total assets owned is the development and sale of real estate. Real Estate activities primarily take the form of securing permits, entitlements, and, in some cases, installing infrastructure for raw land development and then realizing that land's value by the selling of larger parcels to buyers who will take the land further up the value chain, either to home buyers or to operators and lessors or commercial property. Since these land projects span multiple years, the Real Estate segment may incur losses for multiple years while a project is developed until that project is sold resulting in operating income. Our third business is providing timberland-related services to third-party timberland owners and raising investment capital from third parties for private equity timber funds like the Fund.

As of December 31, 2007, we owned 113,000 acres of timberland in western Washington State plus 2,600 acres of real estate held for sale or development. Our third-party Timberland Management & Consulting services have historically been conducted in Washington, Oregon, and California.

Net income for the year ended December 31, 2007 totaled $15.5 million, or $3.21 per diluted ownership unit, on revenues of $51.9 million. For the corresponding period in 2006, net income totaled $24.9 million, or $5.23 per diluted ownership unit, on revenues of $66.3 million. The $15.5 million net income amount for 2007 reflects a $1.9 million fourth-quarter charge to earnings to adjust our reserve for environmental remediation liabilities as described in more detail below. For the year ended December 31, 2007, cash flow from operations was $22.0 million, compared to $43.6 million in 2006. Net income for the quarter ended December 31, 2007 totaled $6.3 million, or $1.30 per diluted ownership unit, on revenues of $17.6 million. This compares to net income of $7.8 million, or $1.63 per diluted ownership unit, on revenues of $16.5 million for the quarter ended December 31, 2006.

Macroeconomic factors that have a significant bearing on our business include housing starts in the U.S., and to a lesser degree in Japan; interest rates; and currency exchange rates, particularly those between the U.S. and Canada, Japan, and Europe. The first two of these factors reflect or influence the health of the U.S. housing market. Currency exchange rates influence the competitiveness of our domestic sawmill customers as it relates to imported lumber from Canada, Europe, or the Southern Hemisphere as well as with the competitiveness of our logs in export markets in Asia. Our export logs are sold to domestic intermediaries who then export the logs. A favorable US$/yen exchange rate can help these intermediaries compete in the Japanese market with logs that originate from Canada, Russia, or the Southern Hemisphere, thus increasing the price that we are able to realize from the sale of this export-quality log volume.

As an owner and manager of timberland, we focus keenly on three "product" markets: lumber, logs, and timberland. Each of these markets has unique and distinct market factors so that they do not move up or down in lockstep with each other. Generally, the lumber market is the most volatile as it responds quickly (even daily) to changes in housing-driven demand and to changes in lumber inventories. Log markets will in turn be affected by what is happening in the lumber spot markets, but pricing shifts typically adjust monthly rather than daily. Log price volatility is also moderated because logs are used to produce products besides just lumber (especially pulp). The market for timberland tends to be less volatile with pricing that lags both lumber and log markets. This is a function of the longer time horizons utilized by timberland investors where the short-swing fluctuations of log or lumber prices become stabilized in acquisition modeling. We watch the lumber market because activity there can presage log price changes. We are in the log market constantly as we negotiate delivery prices to our customers. The timberland market is important as we are constantly evaluating our own portfolio and its underlying value as well as the opportunities to adjust that portfolio through either the acquisition or disposition of such land.

Management's major opportunity and challenge is to grow our revenue base profitably. Our current strategy for adding timberland acreage is centered on our timber fund business model. For example, the Fund acquired 24,000 acres of timberland in late 2006 of which we own 20% and earn both an asset management and on-the-ground timberland management fee from managing these timberlands. Our real estate challenges center around how and when to "harvest" a parcel of land and capture the optimum value increment by selling the property.

Our consolidated revenue in 2007, 2006, and 2005, on a percentage basis by segment, is as follows:

Segment	***2007***	*2006*	*2005*
Fee Timber	**68%**	53%	78%
Timberland Management & Consulting	**3%**	5%	14%
Real Estate	**29%**	42%	8%

Further segment financial information is presented in Note 11 to the Partnership's Consolidated Financial Statements included with this report.

Outlook

We expect 2008 revenue and income to decline from 2007 due to weakness in the real estate and credit markets which impacts both the Fee Timber and Real Estate segments. Over the last few years we have significantly strengthened our balance sheet by reducing our debt-to-capitalization ratio and increasing our cash and short-term investments. Our strong balance sheet provides us the opportunity to defer timber harvest and land sales until these markets improve, and management has announced an intention to take that action, reducing our forecast timber harvest for 2008 by 36% from what we consider to be our sustainable harvest level. We also plan to look for opportunities to acquire timberland through ORM Timber Fund II, Inc. at favorable prices during the current market weakness.

Timber harvest volume in 2008 is expected to decline to 37 MMBF from 55.1 MMBF in 2007. This represents a 33% reduction from prior year and a 36% reduction from our sustainable harvest level of 57 MMBF. The decision to defer harvest was made in response to our expectation of continued weakness in log markets resulting from the slowdown in housing starts that is associated with widely publicized declines in the credit and housing markets. In addition to the planned 32 MMBF harvest from our own lands, we plan to harvest 5 MMBF from the Fund's tree farms in 2008. This represents a 40% reduction from the Fund's sustainable harvest level of 8 MMBF. Revenue generated by the Fund is consolidated into the Partnership's financial statements but does not contribute commensurately to operating income as the timberlands owned by this fund have a separate depletion pool and depletion charges are expected to offset the majority of the net stumpage value realized upon harvest (delivered log price less harvesting and transportation cost). The 80% interest in the Fund owned by third-parties is reported beneath operating income and is labeled Minority Interest-ORM Timber Fund I, LP.

We are also anticipating a decrease in Real Estate operating income, as the market for developable land has weakened in the Pacific Northwest. Until the market improves, we expect to concentrate our Real Estate activities primarily on preparing properties for sale through obtaining valuable entitlements and completing infrastructure improvements. Revenue generated by the Timberland Management & Consulting segment is expected to decrease as a result of the closure of our McCloud consulting office, while we expect to see a slight increase in income from this segment due a reduction in costs related to the same office closure. The reduction in harvest levels from the Fund's properties also is expected to reduce our Timberland Management & Consulting income.

General & Administrative costs in 2008 are expected to decline from 2007. The primary source of this decline will be the capital structure planning costs expensed in 2007 that are not expected to recur in 2008.

RESULTS OF OPERATIONS

The following table reconciles net income for the years ended December 31, 2007 to 2006 and 2006 to 2005. In addition to the table's numeric analysis, the explanatory text that follows describes many of these changes by business segment.

Year to Year Comparisons *(Amounts in $000's except per unit data)*	***2007 vs. 2006 Total***	*2006 vs. 2005 Total*
Net income:		
Year ended December 31, 2007	**$15,508**	
Year ended December 31, 2006	**24,910**	$24,910
Year ended December 31, 2005		13,684
Variance	**$(9,402)**	$11,226

Year to Year Comparisons *(Amounts in $000's except per unit data)*	***2007 vs. 2006 Total***	*2006 vs. 2005 Total*
Detail of earnings variance:		
Fee Timber		
Log price realizations (A)	**$(219)**	$1,813
Log volumes (B)	**440**	(11,295)
Harvest & haul	**(1,203)**	4,583
Depletion	**1,580**	2,993
Other Fee Timber	**19**	173
Timberland Management & Consulting		
Management fee changes	**(433)**	(2,707)
Disposition fees	**(1,343)**	(45)
Other Timberland Mgmnt & Consulting	**(373)**	478
Real Estate		
Development property sales	**(7,409)**	14,436
Environmental remediation	**(1,618)**	46
Other Real Estate	**330**	(1,889)
General & Administrative costs	**(965)**	(166)
Interest expense	**470**	1,100
Other (taxes, minority int., interest inc.)	**1,322**	1,706
Total change in earnings	**$(9,402)**	$11,226

(A) Price variance allocated based on changes in price using the current period volume.

(B) Volume variance allocated based on change in sales volume and the average log sales price for the prior period less variance in log production costs.

Fee Timber

Revenue and Operating Income

Fee Timber revenue is earned primarily from the harvest and sale of logs from the Partnership's 113,000 acres of fee timberland located in western Washington and, to a lesser extent, from the lease of cellular communication towers together with the sale of gravel and other forest products that result from timberland operations. Revenue from the sale of timberland tracts will also appear periodically in results for this segment. Our Fee Timber revenue is driven primarily by the volume of timber harvested, which we ordinarily express in terms of millions of board feet, or "MMBF", and by the average prices realized on log sales, which we express in dollars per thousand board feet, or "MBF". In late 2006, the Fund acquired 24,000 acres of timberland with harvest activities from these properties beginning in 2007 and consolidated into this discussion of operations.

Revenue and operating income for the Fee Timber segment for each year in the three-year period ended December 31, 2007, are as follows (all amounts in $ millions, except as noted).

Year Ended	*Timber revenue*	*Mineral, cell tower, and other revenue*	*Total segment revenue*	*Operating income*	*Harvest volume (MMBF)*
2007	**$33.5**	**$2.0**	**$35.5**	**$15.2**	**55.1**
2006	33.3	2.0	35.3	14.6	54.5
2005	42.7	1.7	44.4	16.3	74.2

FISCAL YEAR 2007 COMPARED TO 2006. Revenue and operating income increased modestly in 2007 from 2006. The increase in revenue was due to an increase in harvest volume partially offset by a decline in average price realized. Harvest volume in 2007 increased 1% from 2006 and includes 5.3 MMBF harvested by the Fund. The increase in harvest volume was offset in part by a decline in average log prices of $4 per MBF, representing a 1% decrease from log prices realized in 2006. Operating income in 2007 attributed to the Fee Timber segment increased $623,000, or 4% from 2006. This increase was due primarily to a decline in depletion expense in 2007 from 2006. Harvest volume in 2006 included 6.6 MMBF from a separate depletion pool that carried a higher depletion rate than our other depletion pools.

FISCAL YEAR 2006 COMPARED TO 2005. Harvest volume declined 27% from 2005 to 2006. This decrease was due to an elevated harvest in 2005 owing primarily to our harvest of two tracts acquired in 2004. Average log prices in 2006 were up $35 per MBF, representing a 6% increase over 2005's log prices. The $301,000 increase in other revenue is due primarily to an increase in gravel royalties due to increased residential and commercial construction activity in our local markets in 2006. The decrease in harvest volume, offset somewhat by stronger prices and increased gravel royalties, resulted in the $9.1 million, or 20%, decrease in Fee Timber revenue for 2006 versus 2005.

Operating income in 2006 attributed to the Fee Timber segment decreased $1.7 million, or 10% from 2005. Harvest volume from one of the 2004 acquisitions has a separate depletion pool because the property has characteristics that are different from the pooled property. Specifically, the timber on this property at the time of acquisition was almost completely merchantable. As a result of accounting for harvests from this particular acreage using the separate depletion pool and its correspondingly high per MBF depletion charge, the incremental harvest from this acquisition generated significant cash flow but had much less impact on operating income. The cash generated through 2005 and into 2006 related to the timber harvested from this particular fourth quarter 2004 acquisition has served to recoup effectively its entire purchase price.

Log Volume

Log volume sold for each year in the three-year period ended December 31, 2007 is as follows:

Volume *(in MMBF)*	***2007***	***% Total***	*2006*	*% Total*	*2005*	*% Total*
Sawlogs						
Douglas-fir	**35.1**	**64%**	38.9	71%	43.7	59%
Whitewood	**6.5**	**12%**	3.8	7%	11.0	15%
Cedar	**2.2**	**4%**	1.1	2%	4.5	6%
Hardwoods	**2.7**	**5%**	3.6	7%	5.1	7%
Pulp						
All Species	**8.6**	**16%**	7.1	13%	9.9	13%
Total	**55.1**	**100%**	54.5	100%	74.2	100%

Log volume increased 1% in 2007 from the 2006 harvest. With the weakened market for Douglas-fir sawlogs, a direct result of the soft housing market, we focused on harvest units with less Douglas-fir volume and more whitewood, cedar, and pulp. This allowed us to take advantage of those selected log markets that remained relatively strong. The export markets for high quality whitewood sawlogs strengthened as log exporters were able to identify low cost opportunities to ship logs to Korea. The market for pulp and cedar strengthened as supplies declined. This is a common occurrence during weak log and lumber markets. Wood chips used to manufacture pulp are a by-product of lumber manufacturing so when mills reduce production, fewer wood chips are created thus increasing demand for pulp logs. Similarly cedar sawlogs can be thought of as a by-product resulting from the harvest of Douglas-fir and whitewood timber stands. When harvest activities decline, production of cedar sawlogs also decline while demand for this type of log is not as tightly tied to housing starts.

Log volume decreased 27% in 2006 from the elevated harvest in 2005 related to the 2004 timberland acquisitions. The 2004 timberland acquisitions were largely harvested in 2005 and contained a relatively high volume of cedar and red alder sawlogs. Pulp log volume as a percentage of total volume remained at 13% in 2006 when compared to 2005.

Log Prices

We have categorized our sawlog volume by species, which is a significant driver of price realized as indicated by the table below. The average log price realized by species for each year in the three-year period ended December 31, 2007, is as follows:

Price $/MBF	***2007***	***% Change***	*2006*	*% Change*	*2005*
Sawlogs					
Douglas-fir	**$621**	**–7%**	$669	4%	$644
Whitewood	**462**	**4%**	445	–6%	472
Cedar	**1,280**	**17%**	1,093	16%	942
Hardwoods	**931**	**37%**	681	13%	605
Pulp					
All Species	**381**	**42%**	268	26%	213
Overall					
All Species	**607**	**–1%**	611	6%	576

DOUGLAS-FIR: Douglas-fir is noted for its structural characteristics that make it generally preferable to other softwoods and hardwoods for the production of construction grade lumber and plywood. Demand and price for Douglas-fir sawlogs is very dependent upon the level of new construction. As construction starts have declined significantly, we have experienced a 7% decline in Douglas-fir log price realized in 2007 from 2006, a trend that led us to front-load our harvest into the earlier parts of 2007 as we have done in prior years. The price realized on Douglas-fir logs increased 4% in 2006 from 2005 due to stronger housing starts in 2006 in the United States. Additional lumber mills opened during 2006 in the Puget Sound area of Washington, thus creating some additional demand and upward price pressure on logs.

WHITEWOOD: “Whitewood” is a term used to describe several softwood species, but for us primarily refers to western hemlock. Though generally considered to be of a lower quality than Douglas-fir, these logs are also used for manufacturing construction grade lumber and plywood. The average price realized on whitewood increased 4% in 2007 from 2006, and decreased 6% in 2006 from 2005. As mentioned above, the whitewood export market strengthened in 2007. Conversely, there was a decline in whitewood market prices during 2006, with this result attributable to harvesting lower quality logs in 2006 versus 2005. Whitewood harvest volume in 2005 included a large component of high quality whitewood sawlogs from one of the 2004 timberland acquisitions which increased our average price realization in the prior year.

CEDAR: Cedar is generally used for outdoor applications such as fencing and decking. Demand for these products is not as tightly linked to housing starts as our other softwood sawlogs. Cedar prices have increased in both 2007 from 2006 and in 2006 from 2005. The strong price realized for 2007 and 2006 reflects a general decline in cedar volume available in the Puget Sound area with resultant upward pressure on price due to continuing demand for such logs.

HARDWOOD: "Hardwood" can refer to many different species, but on our tree farms primarily consists of red alder. The price realized from the sale of red alder sawlogs has increased steadily over the last two years with limited supply and increased demand as a result of new mills focused on hardwood lumber production in the Pacific Northwest. The local mills that process alder sawlogs are using the resource to manufacture lumber for use in furniture construction. Hardwood log prices increased 37% due to an increase in hardwood mill capacity in the Puget Sound area that has increased demand for hardwood sawlogs. Notwithstanding this favorable price trend, hardwood represents a relatively minor species in our sales and timber inventory mix and this only produces a small impact on overall revenue and earnings.

PULP: Pulp is a lower quality log of any species that is manufactured into wood chips. These chips are used primarily to manufacture unbleached linerboard used in paper bags and cardboard boxes. The price realized from the sale of pulp logs is primarily driven by local pulp log inventories. Pulp prices in 2007 were up 42% over 2006. The increases in pulp log prices results from a decline in sawmill production and a corresponding reduction in the inventory of residual chips from lumber manufacturing.

Customers

	2007		*2006*		*2005*	
Destination	*Volume**	*Price*	*Volume**	*Price*	*Volume**	*Price*
Domestic mills	**44.0**	**$652**	44.3	$659	59.0	$632
Export brokers	**2.5**	**612**	3.1	700	5.3	629
Pulp	**8.6**	**382**	7.1	268	9.9	213
Total	**55.1**	**$607**	54.5	$611	74.2	$576

** Volume in MMBF*

Domestic mills purchased 78% of our harvest in 2007 versus 81% in 2006. The decline in the proportion of log volume sold to domestic mills was offset by an increase in volume sold to pulp mills, where prices were 42% higher in 2007 than 2006. Export brokers represent those log buyers that purchase our logs and then resell them primarily to the export market. While export brokers purchased roughly the same volume, prices were 13% lower in 2007 than 2006, due to a shift from selling Douglas-fir to whitewood in the export market. Whitewood has a lower average value than Douglas-fir.

Domestic mills purchased 81% of our harvest volume sold in 2006, and average price realizations were 4% higher than the price realized in 2005. The increase in price realized is due to the strong housing market experienced in 2006. A factor in the increase in average price is the lower valued log mix in 2005 compared to 2006. Harvest volume in 2005 included a large component of whitewood which carries a lower market value than Douglas-fir logs. Volume sold to pulp log customers represented 13% of total volume sold for both 2006 and 2005.

Harvest Volumes and Seasonality

The Partnership's 113,000 acres of timberland consist of both the 70,000-acre Hood Canal tree farm and the 43,000-acre Columbia tree farm. The Hood Canal tree farm is located in the Hood Canal region of Washington State. Most of this tree farm acreage is at a relatively low elevation where harvest activities are possible year-round. As a result of this competitive advantage, we are often able to harvest and sell a greater portion of our annual harvest in the first half of the year when the log supply in the marketplace tends to be lower. In 2007 our harvest was less concentrated in the first quarter of the year due in part to a lower harvest from the Hood Canal tree farm and an uncertain market for logs that led us to a more even-flow harvest schedule in 2007 versus prior years.

The percentage of annual harvest volume by quarter for each year in the three-year period ended December 31, 2007 is as follows:

Year Ended	*Q1*	*Q2*	*Q3*	*Q4*
2007	**18%**	**41%**	**28%**	**13%**
2006	40%	31%	22%	7%
2005	31%	30%	28%	11%

Cost of Sales

Cost of sales for the Fee Timber segment consists of harvest costs and depletion expense. Harvest costs represent the direct cost incurred to convert trees into logs and deliver those logs to their point of sale and associated state excise taxes owed on the harvest of logs. Depletion expense represents the cost of acquiring or growing the timber harvested. We are using two separate depletion rates in 2007, with our primary pool used for volume harvested from the Hood Canal and Columbia tree farms and the second pool for volume harvested from tree farms owned by ORM Timber Fund I, LP. In 2006 and 2005 we also harvested from two separate depletion pools consisting of our primary pool and the pool used for timber harvested from the timberland acquired in the fourth quarter of 2004.

Depletion expense is calculated by first deriving a depletion rate as follows:

$$\text{Depletion rate} = \frac{\text{Accumulated cost of timber and capitalized road expenditures}}{\text{Estimated volume of 40-year-old merchantable timber available for harvest}}$$

The depletion rate is then applied to volume harvested to calculate depletion expense. In 2008 we are changing our definition of "merchantable" to 35-year and older timber.

Fee Timber cost of sales, expressed on a per MBF basis for each year in the three-year period ended December 31, 2007, is as follows:

Year Ended	*Depletion cost per MBF*	*Harvest, haul, and other costs per MBF*	*Total cost of sales per MBF*
2007	**$87**	**$200**	**$287**
2006	110	187	297
2005	142	179	321

As described above, the depletion rate is calculated by dividing the historical cost of the timber and related capitalized road expenditures by merchantable timber volume. That calculated rate is then applied to volume harvested. We harvested a total of 55 MMBF in 2007, with 5 MMBF attributable to the separate depletion pool created for the ORM Timber Fund I, LP timberlands. The depletion rate used in these separate pools approximates the net stumpage value (delivered log price less harvesting and transportation cost) realized on the sale of this particular timber. As such, the incremental harvest from these timberlands results in negligible net income impact even as it generates operating cash flow.

Depletion expense is generated from the harvest and sale of timber and some de minimis amount of depletion results from Real Estate sales when land is sold with standing timber. Depletion expense resulting from timber harvest for each year in the three-year period ended December 31, 2007 was made up of the following:

	Year ended December 31, 2007		
	Pooled	*Timber Fund*	*Total*
Volume harvested (MBF)	**49,824**	**5,337**	**55,161**
Rate/MBF	**$70.31**	**$237.77**	**$86.51**
Depletion expense ($000's)	**$3,503**	**$1,269**	**$4,772**

	Year ended December 31, 2006		
	Pooled	*Quilcene*	*Total*
Volume harvested (MBF)	47,682	6,851	54,533
Rate/MBF	$68.97	$396.63	$110.13
Depletion expense ($000's)	$3,288	$2,717	$6,006

	Year ended December 31, 2005		
	Pooled	*Quilcene*	*Total*
Volume harvested (MBF)	57,194	17,051	74,245
Rate/MBF	$73.29	$374.46	$142.46
Depletion expense ($000's)	$4,192	$6,385	$10,577

Harvest costs vary based upon the physical site characteristics of acreage harvested. Harvest units that are difficult to access, or that are located on steep hillsides requiring cable harvest systems, are more expensive to harvest. Haul costs vary based upon the distance between the harvest site and the customer's location. Per MBF harvest and haul costs increased in 2007 relative to 2006 primarily due to the location of the harvest units, where logs harvested in 2007 compared to 2006 were hauled a greater distance to customer locations. Increased fuel costs further contributed to the increase in haul costs in 2007 over 2006. The increase in harvest and haul costs in 2006 relative to 2005 is due to increased costs from having harvested timber from harvest units located on hillsides rather than harvest units located on relatively flat ground.

Fee Timber cost of sales for each year in the three-year period ended December 31, 2007 is as follows (all dollar amounts in millions):

Year Ended	*Depletion*	*Harvest, haul, and other*	*Total cost of sales*
2007	**$4.8**	**$11.0**	**$15.8**
2006	6.0	10.2	16.2
2005	10.6	13.2	23.8

Fee Timber cost of sales decreased $384,000 in 2007 from 2006 and decreased $7.6 million in 2006 from 2005. The decrease in 2007 from 2006 is due to a decrease in the average depletion rate used on timber harvested offset by increased harvest costs. The decrease in 2006 from 2005 is due to a reduction in harvest from both our pooled and separate depletion pool harvest units.

Operating Expenses

Fee Timber operating expenses for each of the three years ended December 31, 2007, 2006, and 2005 were $4.5 million, $4.4 million, and $4.3 million, respectively. Operating expenses include management, silviculture and the cost of both maintaining existing roads and building temporary roads required for harvest activities. Operating costs remained relatively consistent in all three years despite the addition of 24,000 acres owned by the Fund. This is due primarily to the benefits of scale we enjoy as a result of adding acreage to this segment.

Timberland Management & Consulting

Revenue and Operating Income

The Timberland Management & Consulting segment generates revenue by providing timberland management and forestry consulting services to timberland owners and managers. An additional aspect of that segment's activities is the development of timberland property investment portfolios on behalf of third-party clients and the Timber Fund.

The Timberland Management & Consulting segment is currently managing more than 290,000 acres of timberland for Cascade Timberlands LLC and an additional 24,000 acres for the Fund. The Cascade project includes management, consulting, and disposition services. Revenue and operating income for the Timberland Management & Consulting segment for each year in the three-year period ended December 31, 2007, are as follows (all dollar amounts in millions):

Year Ended	*Revenue*	*Operating income (loss)*
2007	**$1.3**	**$(0.9)**
2006	3.7	1.3
2005	7.8	3.5

FISCAL YEAR 2007 COMPARED TO 2006. Revenue and operating income for 2007 were $2.4 million and $2.2 million lower, respectively, than in 2006. The decrease in 2007 is due to a decline in acres under management due to additional sales of Cascade's timberlands and $1.3 million in non-recurring timberland disposition fees earned in 2006.

The Fund was formed by Olympic Resource Management LLC (ORMLLC) for the purpose of attracting investor capital to purchase timberlands. The Fund had a $61.8 million capital commitment and we placed $58.5 million of this commitment in late 2006. Pope Resources' co-investment totaled $11.7 million, or 20% of the Fund. The Fund is treated as a consolidated subsidiary whose results are reported under the Fee Timber segment. Operating results attributed to the 80% third-party interest in the Fund are reported under Minority Interest-ORM Timber Fund I, LP below operating income.

We are now organizing our second timber fund that we expect will total over $100 million of equity capital, with our co-investment at the same 20% level as in the first fund. As with ORM Timber Fund I, LP we will not be required to contribute the majority of this capital until suitable timber properties are identified and acquired.

FISCAL YEAR 2006 COMPARED TO 2005. Revenue and operating income for 2006 was $4.1 million and $2.2 million lower, respectively, than for 2005. These decreases are due to a decline in acres under management partially offset by timberland disposition fees earned by providing such services to our primary timberland management client, Cascade Timberlands LLC. Cascade's sale of portions of its holdings resulted in a disposition fee earned in the first quarter of 2006 followed by a reduction in timberland management fees. We have entered into an agreement to continue managing Cascade's timberland from 2007 through 2009.

Operating Expenses

FISCAL YEAR 2007 COMPARED TO 2006. Timberland Management & Consulting operating expenses decreased $177,000 in 2007 from 2006. This is attributable to decreased activities associated with Cascade timberlands netted against an increase in organization costs associated with ORM Timber Fund II.

FISCAL YEAR 2006 COMPARED TO 2005. Timberland Management & Consulting operating expenses decreased $1.8 million in 2006 from 2005. The decrease in operating expenses resulted from the closing of two offices that were used for managing timberlands formerly owned by Cascade, and a decrease in activities surrounding capital-raising for the Fund. Following the sale of two of Cascade's tree farms we closed our forestry field offices in Port Angeles, Washington in late 2005 and in Sedro-Woolley, Washington in early 2006. The Timberland Management & Consulting segment was not engaged in raising capital in 2006 but was working to locate suitable timber properties for the Fund. This shift in activities resulted in a decline in operating expense.

Real Estate

Revenue and Operating Income

The Partnership's Real Estate segment consists primarily of revenue from the sale of land together with residential and commercial property rents. The Partnership's real estate holdings are located primarily in Pierce, Kitsap, and Jefferson Counties in Washington State.

Results from Real Estate operations are expected to vary significantly from year to year as we make multi-year investments in entitlements and infrastructure prior to selling entitled or developed land, and from time-to-time we have described these results as "lumpy" in terms of their impacts on our revenues and operating cash flows. Revenue and operating income for the Real Estate segment for each year in the three-year period ended December 31, 2007, are as follows (all dollar amounts in millions):

Year Ended	*Revenue*	*Environmental remediation expense*	*Operating income*
2007	**$15.0**	**$1.9**	**$5.2**
2006	27.3	0.3	13.9
2005	4.8	0.2	1.3

Revenue in the Real Estate segment is generated through the sale of land and the rental of homes and commercial properties at the Port Gamble townsite. Land sales include the sale of raw land which generally consists of larger acreage sales rather than single lot sales and are normally completed with very little capital investment prior to sale. Rural Residential lot sales generally require some capital improvements such as zoning, road building, or utility access improvements prior to completing the sale. Commercial and residential plat land sales represent land sold after development rights have been obtained and are generally sold with certain infrastructure improvements.

Real Estate segment revenue for each year in the three year period ended December 31, 2007 consists of the following (all dollar amounts in thousands):

Description	*Revenue*	*Gross Margin*	*Acres Sold*	*Revenue/ Acre*	*Gross Margin/ Acre*
Commercial/ business park	$11,124	$7,155	15	$719	$463
Revenue recognized on % complete for 2006	1,346	838	NA	NA	NA
Other land sale	1,018	964	91	11	11
Rural residential	553	458	50	11	9
Rentals	982	982	NA	NA	NA
Other	14	15	NA	NA	NA
2007 Total	**$15,037**	**$10,412**	**156**	**$81**	**$55**
Commercial/ business park	$11,637	$6,184	37	$315	$167
Residential plat	10,673	7,715	200	53	39
Rural residential	2,596	1,872	527	5	4
Other land sale	1,400	1,003	401	4	3
Rentals	1,002	1,002	NA	NA	NA
Other	12	12	NA	NA	NA
2006 Total	$27,320	$17,788	1,165	$23	$14
Rural residential	$2,967	$2,276	524	$6	$4
Other land sale	890	848	390	2	2
Rentals	914	NA	NA	NA	NA
Other	47	34	NA	NA	NA
2005 Total	$4,818	$3,158	914	$3	$3

FISCAL YEAR 2007 COMPARED TO 2006. In 2007, revenue and operating income for the Real Estate segment decreased by $12.3 million and $8.7 million, respectively, over 2006 amounts. The large revenue decrease can be attributed to a decline in the real estate market in 2007 coupled with the unrepeated milestone transactions occurring in 2006. Notwithstanding the decrease from 2006, the results achieved in 2007 still represent the upside of cyclical trends.

Commercial/business park transactions in 2007 included sales from our Gig Harbor and Bremerton projects and a single acre of property located in Poulsbo, Washington. In Gig Harbor we sold a total of 12 acres resulting in $9.9 million of revenue and $6.6 million of gross margin. These Gig Harbor transactions included a 6-acre sale for $7.2 million that was closed in 2006 but due to a right of rescission the revenue was not recognized until 2007 when this right of rescission terminated after we completed required infrastructure improvements. At our Bremerton West Hills project we sold two industrial lots representing over 2 acres resulting in $1.0 million of revenue and $0.4 million of gross margin. The remaining commercial/business park property sale was a 1-acre parcel near our headquarters in Poulsbo that was sold for $230,000 resulting in gross margin of $166,000.

Revenue recognized using the percentage completion method primarily related to the 2006 sale of a 200-acre, residential plat from our Bremerton West Hills project. Certain obligations under the purchase and sale agreement were not completed as of December 31, 2006 and, as a result, 2007 results include $1.3 million in revenue and $838,000 of gross margin from this sale.

The 91-acre, $1.0 million "Other Land Sale" in the preceding table represents a sale to Kitsap County Parks. This land will be used as part of a public trail system that we expect to add value to the community and our development properties in North Kitsap County.

The Partnership's Rural Residential lot program typically produces lots from 5 to 80 acres in size, based on underlying zoning densities. This type of program entails an entitlement effort typically consisting of simple lot segregations and boundary line adjustments. Development activities include minor road building, surveying, and the extension of utilities. Rural Residential revenue in 2007 consisted of 3 separate transactions totaling 50 acres and represented a 91% decrease in acres sold compared to 2006. Demand for rural lots has dropped significantly in 2007 commensurate with decreased demand for housing.

Management intends to build on the success of these disposition efforts and offer a steady supply of rural residential lots to the market that will result in an ongoing revenue stream for the Real Estate segment. We have a target of selling 150 to 300 acres annually from this. We expect 2008 rural residential sales to end up at the low end of this targeted range due to softening in our local markets for rural residential land.

FISCAL YEAR 2006 COMPARED TO 2005. In 2006, revenue and operating income for the Real Estate segment increased by $22.5 million and $12.6 million, respectively, over 2005 amounts. Results in 2006 epitomized the upside of this reality as we sold properties from two projects following multiple years of investment.

At our development project in Gig Harbor, Washington we sold a total of nearly 29 acres of those portions of the property zoned as either commercial or business-park resulting in $9.5 million of revenue and $5.9 million of gross margin. These transactions represent the culmination of a number of years of investment and work with community and political leaders to build support for the project. The remaining commercial/business park property sale recognized as revenue in 2006 was for 8 acres of property contiguous to our headquarters building in Poulsbo, Washington.

The 200-acre, $10.7 million residential plat sale identified in the preceding table was from our Bremerton West Hills project. The 401-acre, $1.4 million "Other Land Sale" in the preceding table represents environmentally sensitive property sold to the Nisqually Land Trust. This transaction is an excellent example of private industry working with environmental interests to promote a win-win outcome for various public and private interests. The Nisqually Land Trust's acquisition protects a forested parcel near the entrance to Mount Rainier National Park while allowing us to redeploy the capital to other timberland or real estate opportunities.

Rural Residential revenue in 2006 consisted of 13 separate transactions totaling 527 acres. Prices per acre realized from these sales are affected by whether the property is sold with legal access. In 2006 Rural Residential acreage sales included 78 acres sold without first obtaining legal access. These sales grossed an average of $3,943 per acre, while the remaining 444 acres that were sold with legal access grossed an average of $5,097 per acre.

Cost of Sales

Real Estate cost of sales for each of the three years ended December 31, 2007, 2006, and 2005 were $4.6 million, $9.5 million, and $748,000, respectively. Cost of sales during the periods presented result from the aforementioned land sales. The decrease in cost of sales in 2007 relative to 2006 was due primarily to a decrease in acres sold.

Operating Expenses

Real Estate operating expenses for each of the three years ended December 31, 2007, 2006, and 2005 were $3.4 million, $3.7 million, and $2.6 million, respectively. Operating expenses decreased $293,000 in 2007 compared to 2006. Lower operating expenses in the Real Estate segment are due to project-related expenditures incurred in connection with a number of projects, particularly at Gig Harbor, Bremerton, Kingston, and Port Gamble.

Environmental Remediation

The Partnership has accrued liabilities for environmental cleanup of $2.0 million and $242,000 as of December 31, 2007 and 2006, respectively, for estimated environmental remediation charges in and around the townsite of Port Gamble. Port Gamble is a historic town that was owned by P&T for decades until 1985 when the townsite and other assets were spun off to the Partnership. P&T continued to operate the townsite through 1995 and leased the millsite at Port Gamble until January 2002 when a settlement agreement was signed between the Partnership and P&T. This settlement agreement set forth how the two companies would apportion the costs and responsibility for environmental remediation in Port Gamble. The "millsite" is referred to as such because a lumber mill operated on that portion of the property for more than one hundred years until 1995, before it was dismantled by the end of 1996.

Our results for fourth quarter and fiscal year 2007 reflect a $1.9 million charge to earnings to increase our environmental remediation liability. This amount reflects our estimate of potential liability associated with environmental contamination at Port Gamble. This contamination is believed to have occurred during the years P&T operated a mill at Port Gamble, from 1853 to 1995. At the time Pope Resources was spun off from P&T, Port Gamble was included in our assets, and after contamination was discovered at the town site, mill site, and in the adjacent bay, we entered into a settlement and remediation agreement with P&T pursuant to which we and P&T allocated responsibility for cleanup costs. Under Washington law, both Pope Resources and P&T are "potentially liable persons" based on ownership and/or operation of the site. These laws provide for joint and several liability among parties owning or operating property on which contamination occurs, meaning that cleanup costs can be assessed against any or all such parties. Our agreement with P&T was intended to apportion responsibility based on this principle, with P&T bearing the larger share of responsibility based upon their role in operating the site and upon their relatively lengthy ownership.

However, P&T's financial condition has declined markedly in recent years, having first disclosed questions about its ability to continue as a going concern in its Annual Report on Form 10-K for the fiscal year ended December 31, 2006. Since that time we have closely monitored P&T's financial disclosures, including its repeated attempts to restructure its credit arrangements throughout the second and third quarters of 2007 and culminating in a late October 2007 bankruptcy filing in Canada, followed in November 2007 by a Chapter 11 bankruptcy filing in the United States. Since then, P&T has undertaken to sell substantially all of its assets. These events raised substantial doubt in management's views as to whether P&T can meet all or any portion of its obligations under our settlement and remediation agreement.

Because of the joint and several liability that attends to the cleanup obligation, management has taken a number of steps to address our own exposure as follows:

- As noted above, we have increased our remediation estimate by $1.9 million to reflect our current estimate of the remediation costs.
- In the fourth quarter of 2006 we revised our methodology for assessing this liability, shifting to a "Monte Carlo simulation" analysis which we hope will improve our ability to predict the actual liability for the remaining cleanup. We believe that a Monte Carlo simulation model is a useful tool for estimating the costs of a complex project where many different activities may have a wide variety of possible outcomes. A Monte Carlo simulation model allows the user

to establish high, medium, and low cost estimates for discrete tasks within the project, and then to assign probability estimates for specific outcomes. Using these inputs, the simulation ultimately generates a data set of 3,000 randomly generated outcomes with related costs and provides the capability to map these on a histogram with the axes defining "frequency" and "total cost". Additionally, the simulation produces a range of costs with probability-of-outcome percentiles attached to each. Our new methodology adopts the practice of accruing to the dollar amount that corresponds to the 50th percentile, such that there is a 50% probability that costs will not exceed such amount based on the simulation exercise, as we believe this is the best available estimate.

- We are in active discussions with the Washington State Department of Ecology to promote protection of the environment, optimize and appropriately allocate the remaining cleanup liabilities, and maximize our control over the remediation process.
- We are participating actively in the P&T bankruptcy action as an unsecured creditor in an effort to maximize any potential recovery from P&T's remaining assets, although we have substantial doubt as to whether we will recoup any material portion of those assets because substantially all of P&T's assets are subject to the security interests of its lenders.

Although management continues to monitor closely both the Port Gamble cleanup process and the P&T bankruptcy proceeding, our addition of $1.9 million to the remediation liability reflects what management believes to be the best estimate of the remaining cleanup cost based upon an estimation method that represents the most likely outcome.

The environmental liability at December 31, 2007 includes $250,000 that the Partnership expects to expend in the next 12 months and $1.75 million thereafter. Current activities at the site include dismantling a sparge area of dredged materials on the millsite itself and costs for developing a clean up plan for the site as a whole. Activity in the environmental remediation liability is detailed as follows:

Year Ended	*Balances at the beginning of the year*	*Additions to accrual*	*Expenditures for remediation*	*Balances at the end of the year*
2005	$474,000	$198,000	$514,000	$158,000
2006	158,000	260,000	176,000	242,000
2007	**242,000**	**1,878,000**	**126,000**	**1,994,000**

General & Administrative (G&A)

FISCAL YEAR 2007 COMPARED TO 2006. G&A costs increased $965,000, or 25%, to $4.8 million from $3.8 million in 2006. The increase in general and administrative expenses is due primarily to professional service fees incurred to evaluate capital structuring alternatives with management and the Board of Directors of the General Partner. G&A costs represented 9% of revenue in 2007.

FISCAL YEAR 2006 COMPARED TO 2005. G&A costs increased $166,000, or 5%, to $3.8 million from $3.7 million in 2005. The increase in general and administrative expenses experienced in 2006 is due to an increase in costs associated with new internal control reporting and related audit requirements under the Sarbanes Oxley Act. G&A costs represented 6% of revenue in 2006 and 2005.

Interest Income and Expense

Interest income for 2007 increased to $1.8 million in 2007 from $1.2 in 2006 and $402,000 in 2005. The increase in interest income is due to higher average cash and short-term investment balances. Our combined cash and short-term investments balance in 2007 grew from $32.2 million at December 31, 2006 to $32.9 million at December 31, 2007. We have invested cash in excess of immediate operating cash requirements in auction rate securities, which in our case are currently student loans backed with the highest credit rating of Aaa/AAA. The maturities on these securities are long-term while the interest rate resets every 28 days.

Interest expense net of interest capitalized to development projects was $1.4 million for 2007, $1.8 million for 2006 and $2.9 million in 2005. The decrease in interest expense from 2006 to 2007 is attributable to regularly scheduled principal payments due on our timberland mortgage and an increase in capitalized interest related to increased basis on land projects under development. The Partnership's debt consists primarily of mortgage debt with a fixed interest rate and amortization schedule. The outstanding debt has not been reduced with available cash and short-term investment balances because the terms of the timberland mortgages include a "make whole" premium paid to the lender for unscheduled principal payments.

Income Taxes

Pope Resources is a limited partnership and is, therefore, not subject to income tax. Instead, taxable income/loss flows through and is reported to unitholders each year on a Form K-1 for inclusion in each unitholder's tax return. Pope Resources does, however, have corporate subsidiaries that are subject to income tax and this is why a line item for such tax appears on the statements of operations. The corporate tax-paying entities are utilized for our third-party service fee businesses.

FISCAL YEAR 2007 COMPARED TO 2006. We have recorded an income tax benefit of $69,000 in 2007, whereas we had recorded a provision for income taxes of $439,000 in 2006. The tax benefit results from the operating loss generated by our Timberland Management & Consulting segment and increased costs associated with launching our second timber fund as previously described.

FISCAL YEAR 2006 COMPARED TO 2005. We recorded a provision for income taxes of $439,000 in 2006 and $1.0 million in 2005. The decrease in tax expense is due to the decline in income generated by our Timberland Management & Consulting segment that tracks with the decline in acres under management as previously described.

Minority Interest-ORM Timber Fund I, LP

Minority Interest-ORM Timber Fund I, LP represents the 80% portion of 2007 net loss of the Fund attributed to third-party owners of the Fund. The increase in this amount from prior year is due to the increase in operating activities of the Fund given its acquisition of timberland in late 2006.

Minority Interest-IPMB

Minority Interest-IPMB represents that share of income earned from the Investor Portfolio Management Business (IPMB) allocated to Pope MGP, Inc., the Managing General Partner of the Partnership. The 1997 amendment to the Limited Partnership Agreement authorizing the Partnership to pursue the IPMB further specifies that income from the IPMB will be split using a sliding scale allocation method beginning at 80% to the Partnership's wholly-owned subsidiary, ORM, Inc., and 20% to Pope MGP, Inc. The sliding scale allocation method evenly divides IPMB income between ORM, Inc. and Pope MGP, Inc. once such income reaches $7,000,000 in a given fiscal year. The share of IPMB allocated to Pope MGP is further split between Pope MGP and a management incentive plan. In 2007, Pope MGP's share of the IPMB was $0.

Current activities of the IPMB are contained in the Timberland Management & Consulting segment, which include timberland consulting, management and disposition services, and expenses associated with the launch of a second private equity timber fund.

FISCAL YEAR 2007 COMPARED TO 2006. The charge or expense that is the allocation of income to a minority interest decreased to zero in 2007 from $77,000 in 2006. The decrease in minority interest allocation is due to the reduction in the per-acre management fee rate for our primary timberland management client and expenses associated with launching our second timber fund.

FISCAL YEAR 2006 COMPARED TO 2005. The charge or expense that is the allocation of income to a minority interest decreased to $77,000 in 2006 from $321,000 in 2005. The decrease in minority interest allocation is due to the decline in Timberland Management & Consulting results resulting from the decrease in acres under management for Cascade.

LIQUIDITY AND CAPITAL RESOURCES

Cash Flows

We ordinarily finance our business activities using funds from operations and, where appropriate in management's assessment, bank lines of credit. We generate operating cash flow through the sale of timber products; by providing timberland management, disposition, and consulting services; by developing timberland investment portfolios for third-parties; and by selling land for development. Significant recurring uses of cash include the following: replanting and fertilizing trees; maintaining an adequate road system on our tree farms; investing in our development properties; funding annual debt payments on timber mortgages and local improvement district debt; funding quarterly cash distributions; and funding general and administrative expenses.

Funds generated internally from operations and externally through financing are expected to provide the required resources for the Partnership's future capital expenditures. The Partnership's debt-to-total-capitalization ratio as measured by the book value of equity was 24% at December 31, 2007 versus 27% at December 31, 2006. The Partnership's debt consists primarily of timberland mortgages with fixed amortization schedules and loan terms that include a prepayment penalty. We currently operate without an operating line of credit due to the cash we hold in excess of our current operating needs. We will continue to monitor and forecast our expected cash requirements and re-establish a line of credit if a need for additional liquidity should arise.

Now that ORM Timber Fund I, LP is invested we are working on raising capital for a second, follow-on fund. Management anticipates that this second fund will be sized at approximately $100 million and that we will co-invest at the same 20% level ($20 million in this case), as was done for the first fund.

The annual harvest target for 2008 is expected to be approximately 37 MMBF as compared to 55 MMBF in 2007. This represents a 33% reduction from prior year and a 36% reduction from our sustainable harvest level of 57 MMBF. The decision to defer harvest was made in response to our expectation of continued weakness in the market for sawlogs resulting from the slowdown in housing starts. We plan to harvest 5 MMBF from the tree farms owned by the Fund in 2008. This represents a 40% reduction from the Fund's sustainable harvest level of 8 MMBF.

During the year ended December 31, 2007, overall cash and cash equivalents decreased $5.0 million while we invested an additional $5.8 million in short-term investments. This compares to the year ended December 31, 2006 when we experienced an increase in cash and cash equivalents of $3.8 million and invested $10.0 million in short-term investments.

OPERATING CASH ACTIVITIES. The table below provides the components of operating cash flows for each year of the three year periods ended December 31, 2007. Cash received from customers and paid to suppliers and employees results from the harvest and sale of forest products from our tree farms; timberland management, disposition, and consulting services provided to timberland owners; and finally, the sale of our development properties.

Operating cash activities

(in thousands)	***2007***	*2006*	*2005*
Cash received from customers	**$47,667**	$69,548	$56,730
Cash paid to suppliers and employees	**(24,473)**	(25,030)	(25,232)
Interest received	**1,712**	1,095	377
Interest paid	**(2,585)**	(1,795)	(2,892)
Income taxes paid	**(340)**	(247)	(74)
Total	**$21,981**	$43,571	$28,909

Cash generated by operating activities decreased to $22.0 million in 2007 from $43.6 million in 2006. The decrease in cash generated by operating activities resulted primarily from two major non-recurring land sales in 2006 that resulted in nearly $20.0 million of cash flow.

Cash generated by operating activities increased to $43.6 million in 2006 from $28.9 million in 2005. The increase in cash generated by operating activities resulted primarily from two major land sales that resulted in nearly $20.0 million of cash flow.

CASH USED IN INVESTING ACTIVITIES. The table below represents the annual components of cash used by year in investing activities for each of the three-year periods ended December 31, 2007. Recurring investing activities consist primarily of tree planting, road building and investment in our development properties to build infrastructure and acquire the entitlements necessary to make further development of the properties possible.

Investing activities

(in thousands)	***2007***	*2006*	*2005*
Buildings and equipment	**$793**	$622	$784
Development properties	**9,868**	10,458	4,960
Timber and roads	**1,501**	1,098	1,012
Timberland acquisitions	**–**	57,805	–
Purchase of short-term investments	**5,775**	10,000	15,000
Proceeds from the sale of fixed assets	**(64)**	–	(6)
Cash used in investing activities	**$17,873**	$79,983	$21,750

Cash used in investing activities decreased to $17.9 million in 2007 from $80.0 million in 2006. The decrease in 2007 from 2006 is due primarily to the Fund's 2006 $57.8 million acquisition of two timber properties. In 2007 we invested $5.8 million in short term investments and $793,000 of other capital expenditures. Cash used to purchase short-term investments represents the acquisition of auction rate securities that are being used as a vehicle for investing cash balances in excess of cash required for immediate operating needs. We incurred capital expenditures for development costs in 2007 for the following Real Estate properties: $2.9 million at Gig Harbor, $2.6 million at Bremerton, $1.6 million for a land acquisition that is contiguous to the Port Gamble townsite, $1.1 million of capitalized interest related to the Gig Harbor and Bremerton projects, $828,000 at Hansville, $610,000 at Arborwood and $23,000 related to other miscellaneous projects.

Cash used in investing activities increased to $80.0 million in 2006 from $21.8 million in 2005. Investing activities in 2006 consisted primarily of the Fund's $57.8 million acquisition of two timber properties. Eighty-percent of the cash used by the Fund to purchase this timberland was sourced from $46.8 million of third-party investor capital contributions. Additional investing activities of the Partnership consisted of $10.0 million of auction rate securities and $12.2 million of capital expenditures. We incurred capital expenditures for development costs in 2006 for the following Real Estate properties: $8.7 million at Gig Harbor; $1.4 million at Bremerton; and $398,000 on the Partnership's other development properties. Other capital expenditures included $1.1 million of reforestation and road building costs on our owned timberlands; and $622,000 of buildings and equipment expenditures, with nearly three-fourths of this total related to the Port Gamble townsite.

CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES. The following table represents the components of cash used in financing activities for each year of the three-year period ended December 31, 2007. Our financing activities primarily reflect payments made on timber mortgages and other debt, unitholder distributions, capital contributions by third-party investors in the timber funds, and payments to the Managing General Partner, Pope MGP, for its minority interest allocation of IPMB income. These payments and outflows are partially offset by cash received from the exercise of unit options issued to employees and directors.

Financing activities

(in thousands)	***2007***	*2006*	*2005*
Mortgage/LID payments	**($1,481)**	($1,675)	($1,883)
Net (paydown) draw on line of credit	**–**	–	(758)
ORM Timber Fund I, LP Capital Contributions	**–**	46,831	–
Cash distribution to unitholders	**(6,929)**	(4,961)	(3,701)
Unit repurchase	**(1,374)**	–	–
Cash received from unit option exercises	**730**	254	1,813
Minority interest distribution	**(74)**	(204)	(26)
Cash provided (used) by financing activities	**($9,128)**	$40,245	($4,555)

Cash used by financing activities was $9.1 million in 2007 as compared to $40.2 million provided by financing activities in 2006. This change is due primarily to $46.8 million of capital contributions received by third-party investors to the ORM Timber Fund I. Cash of $1.4 million was used to acquire Partnership units pursuant to a unit repurchase plan authorizing the acquisition of up to $5.0 million of Partnership units commencing November 1, 2007 and continuing for up to one year. Cash distributions were $2.0 million higher in 2007 than 2006 due to an increase in our per unit quarterly distributions from $0.28 to $0.40 per unit in the third quarter of 2007.

Cash generated from financing activities increased to $40.2 million for 2006 from $4.6 million used in 2005. Cash generated by financing activities in 2006 consisted of $46.8 million of capital contributions to the Fund by third-party investors, and $254,000 received from the exercise of unit options, which is partially offset by the following: unitholder distributions totaling $5.0 million, $1.7 million of payments on long-term debt, and $204,000 in minority interest distributions. In the third quarter of 2006 we increased our quarterly distribution from $0.25 to $0.28 per unit.

Expected future changes to cash flows

OPERATING ACTIVITIES. As discussed above, we plan to decrease the Partnership's annual harvest volume from 55 MMBF in 2007 to 37 MMBF in 2008. As announced, this reduction is in response to expected soft prices for logs as the slowdown in housing starts has curtailed demand for solid wood products. The decreased harvest level will translate to lower cash flow from Fee Timber operations in 2008. Cash generated by Real Estate transactions is also expected to decline in 2008 from 2007.

INVESTING ACTIVITIES. Management is now working on securing capital commitments for a second fund. The level of co-investment in the second fund is expected to be the same 20% as was the case in the first fund, but the size of the second fund is expected to exceed $100 million. In addition to these co-investment obligations, capital infrastructure expenditures for our Gig Harbor and Bremerton projects are expected to total $2.2 million and $508,000, respectively, in 2008. The majority of Gig Harbor capital expenditures in 2008 are expected to reflect work on the residential plat entitlement, utility connections, capitalized interest and infrastructure on the property. Capital expenditures on the Bremerton property in 2008 will primarily relate to road and utility extension.

FINANCING ACTIVITIES. Management is currently projecting that cash on hand, short-term investments, and cash generated from operating activities will be sufficient to bridge the front-loading of the capital needs for development properties and co-investments in future timber funds. This point of view reflects management's rationale for not renewing our bank line of credit, which has been utilized by the Partnership at various times in its history. We may incur debt in the future to either co-invest in future timber funds or to fund significant capital improvements on our development properties if management determines operating cash flows or cash reserves are not sufficient to cover these expenditures.

Our debt-to-total-capitalization ratio as of December 31, 2007, as measured by the book and market value of our equity, was 24% and 13%, respectively. Should a financing need arise, management is comfortable that there is room to take on some debt with the ratios at these levels, since our loan covenant which limits debt-to-

total-capitalization to 50% is measured against the lower of these two calculations. The Hood Canal tree farm secures the Partnership's current timberland mortgages while the Columbia tree farm is not currently used as collateral for any debt obligations. To date the Partnership's strong financial position has enabled fairly easy access to credit at reasonable terms when needed.

Seasonality

FEE TIMBER. The Partnership owns 113,000 acres of timberland in Washington State. Our timber acreage is concentrated in two non-contiguous tree farms: the 70,000-acre Hood Canal tree farm located in Kitsap, Jefferson, and Mason Counties on the eastern side of Washington's Olympic Peninsula, and the 43,000-acre Columbia tree farm located in Cowlitz, Clark, Lewis, and Skamania counties on the western side of Washington's Cascade mountain range.

The Hood Canal tree farm is concentrated at low elevations, which permits us to harvest trees year-round. Generally, we concentrate our harvests from this tree farm in the winter and spring when supply, and thus competition, is typically lower and, accordingly, when we can expect to receive higher prices. With the acquisition of the Columbia tree farm in 2001, and the timberlands acquired by the Fund in 2006, management expected a decrease in the seasonality of Fee Timber operations as the Columbia tree farm and timberlands owned by the Fund are at higher elevations where harvest activities are generally possible only in the late spring and summer months. In practice, over the last two years our harvest has tended to be more front-loaded, as log prices have been relatively strong in the first half of the year and winter weather has been relatively benign, enabling management to front-load the harvest plan. In future periods, management expects quarterly harvest volume to be affected by both local market conditions for logs and weather conditions. The weak log markets we are currently experiencing will lead to a relatively low harvest in the first quarter of 2008.

TIMBERLAND MANAGEMENT & CONSULTING. Timberland Management & Consulting operations are not significantly seasonal.

REAL ESTATE. While Real Estate results are not expected to be seasonal, the nature of the activities in this segment will likely result in periodic large transactions that will have significant positive impacts on both revenue and operating income of the Partnership in periods in which these transactions close, and relatively limited revenue and income in other periods, with the 2006 year a classic case-in-point. While the "lumpiness" of these results is not primarily a function of seasonal weather patterns, we do expect to see some seasonal fluctuations in this segment because of the general effects of weather on Pacific Northwest development activities.

Contractual Obligations, Commercial Commitments and Contingencies

Our commitments at December 31, 2007 consist of operating leases, and purchase obligations entered into in the normal course of business.

	Payments Due By Period /Commitment Expiration Date				
Obligation or Commitment *(in 000's)*	*Total*	*Less than 1 year*	*1–3 years*	*4–5 years*	*After 5 years*
Total debt	$30,727	$1,342	$2,684	$26,701	$–
Operating leases	81	67	12	2	–
Interest on debt	9,851	2,456	4,576	2,819	-
Unconditional purchase obligations	145	145	–	–	–
Environmental remediation	1,994	250	1,744	–	–
Other long-term obligations	297	75	92	50	80
Total contractual obligations	$43,095	$4,335	$9,108	$29,572	$80

Unconditional purchase obligations represent contracted infrastructure construction at the Bremerton property. Environmental remediation represents our estimate of potential liability associated with environmental contamination at Port Gamble. Other long-term obligations consist of a $204,000 liability for a supplemental employment retirement plan and a $93,000 contribution commitment to the YMCA of Pierce County's fund for building a new facility at Gig Harbor. This commitment was made as part of the sale of business park property at the Gig Harbor project to the YMCA.

The Partnership may from time-to-time be a defendant in lawsuits arising in the ordinary course of business. Management believes that loss to the Partnership, if any, will not have a material adverse effect to the Partnership's consolidated financial condition or results of operations.

Off-Balance Sheet Arrangements

The Partnership is not a party to off-balance sheet arrangements and does not hold any variable interests in unconsolidated entities.

Capital Expenditures and Commitments

Projected capital expenditures in 2008 are $6.7 million, excluding any potential co-investment by the Partnership in ORM Timber Fund II, Inc. Projected capital expenditures are currently expected to include $2.2 million for the Gig Harbor site and $0.5 million for the Bremerton site. These expenditures could be increased or decreased as a consequence of future economic conditions. Projected capital expenditures are subject to permitting timetables and progress towards closing on specific land sale transactions.

Government Regulation

Compliance with laws, regulations, and demands usually involves capital expenditures as well as operating costs. We cannot easily quantify future amounts of capital expenditures required to comply with laws, regulations, and demands, or the effects on operating costs, because in some instances compliance standards have not been developed or have not become final or definitive. Accordingly, at this time we have not included herein a quantification of future capital requirements to comply with any new regulations being developed by United States regulatory agencies.

Additionally, many federal and state environmental regulations, as well as local zoning and land use ordinances, place limits upon various aspects of our operations. These limits include restrictions on our harvest methods and volumes, remediation requirements that may increase our post-harvest reclamation costs, ESA limitations on our ability to harvest in certain areas, zoning and development restrictions that impact our real estate segment, and a wide range of other existing and pending statutes and regulations. Various initiatives are presented from time-to-time that seek further restrictions on timber and real estate development businesses, and although management currently is not aware of any material noncompliance with applicable law, we cannot assure readers that we ultimately will be successful in complying with all such regulations or that additional regulations will not ultimately have a material adverse impact upon our business.

ACCOUNTING MATTERS

Accounting Standards Not Yet Implemented

In December 2007, the FASB issued SFAS No. 141R, *Business Combinations*, and SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*. These standards were issued jointly and will require most identifiable assets, liabilities, noncontrolling interests, and goodwill acquired in a business combination to be recorded at full fair value and will require noncontrolling interests (previously referred to as minority interests) to be reported as a component of equity, which changes the accounting for transactions with noncontrolling interest holders. Both statements are effective for fiscal years beginning on or after December 15, 2008. SFAS No. 141R will be applied only to acquisitions subsequent to the effective date. SFAS No. 160 will be applied prospectively to all noncontrolling interests, including any that arose before the effective date, except that the presentation and disclosure requirements will be applied retrospectively.

Although management is currently in the process of evaluating the impact of these standards on the Partnership's consolidated financial statements, management expects the impact to include reclassification of the minority interests to equity.

Critical Accounting Policies and Estimates

Management believes its most critical accounting policies and estimates relate to calculations of timber depletion and liabilities for matters such as environmental remediation, and potential asset impairments. In relation to liabilities, potential impairments and other estimated charges, it is management's policy to conduct ongoing reviews of significant accounting policies and assumptions used in the preparation of the financial results of the Partnership. The assumptions used are tested against available and relevant information and reviewed with subject-matter experts for consistency and reliability. During the preparation of financial results, tests are conducted to ascertain that the net book carrying values of assets are not in excess of estimated future cash flows. These tests use current market information, if available, or other generally accepted valuation methods, such as future cash flows. When the use of estimates is necessary, an exact answer is unlikely, and therefore, the range of likely outcomes is used in the preparation of the financial statements. Tests are also applied in order to be reasonably assured that liabilities are properly reflected on the records of the Partnership and that the notes to the financial statements are prepared in a fashion that informs readers of possible outcomes and risks associated with the conduct of business.

PURCHASED TIMBERLAND COST ALLOCATION. When the Partnership acquires timberlands, a purchase price allocation is performed that allocates cost between the categories of merchantable timber, premerchantable timber, and land based upon the relative fair values pertaining to each of the categories. When timberland is acquired the land is separately evaluated for current value.

DEPLETION. Depletion represents the cost of timber harvested and the cost of the permanent road system and is charged to operations by applying a depletion rate to volume harvested during the period. The depletion rate is calculated on January 1st of each year by dividing the Partnership's cost of merchantable timber and the cost of the permanent road system by the volume of merchantable timber. For purposes of the depletion calculation in 2007, merchantable timber is defined as timber that is equal to or greater than 40 years of age. Beginning in 2008 we have defined merchantable timber in our depletion calculation as equal to or older than 35 years of age. Dropping from the 40-year-old to the 35-year-old threshold would have decreased 2007 depletion expense by approximately $262,000.

To calculate the depletion rate, the Partnership uses a combined pool when the characteristics of the acquired timber are not significantly different from the Partnership's existing timberlands. The depletion cost on recently acquired timber, such as timber harvested from ORM Timber Fund I, LP timberland, is expected to approximate the net stumpage realized on the sale, which will result in relatively little net income impact from the harvest but will generate operating cash flow.

Timber inventory volumes take into account the applicable state and Federal regulatory limits on timber harvests as applied to the Partnership's properties. Washington State's forest practice regulations provide for expanded riparian management zones, wildlife leave trees, and other harvest restrictions to protect various fish and other wildlife species. Timber inventory volume is accounted for by the Partnership's standing timber inventory system, which utilizes annual statistical sampling of the timber (cruising) together with adjustments made for estimated annual growth and the depletion of areas harvested.

The standing inventory system is subject to two processes each year to monitor accuracy. The first is the annual cruise process and the second is a comparison of (a) volume actually extracted by harvest to (b) inventory in the standing inventory system at the time of the harvest. A "cruise", which utilizes statistical sampling techniques, represents a physical measurement of timber on a specific set of acres. The cruise process is completed when the physical measurement totals are compared to the volume captured in the standing inventory system. Only productive acres with timber that is at least 20 years old are selected as subject to a cruise. The Partnership cruises 15–20% of its productive acres with 20-year-old or greater timber annually. Specific acres are first selected for cruising with a bias towards those acres that have gone the longest without a cruise and, second, with a bias towards those acres that have been growing the longest. As the cruise is being performed, only those trees with a breast height diameter (approximately 4.5 feet from the ground) of at least 6 inches are measured for inclusion in the inventory.

A hypothetical 5% change in estimated timber inventory volume would have changed 2007 depletion expense by $184,000.

ENVIRONMENTAL REMEDIATION. The environmental remediation liability represents estimated payments to be made to monitor (and remedy if necessary) certain areas in and around the townsite and millsite of Port Gamble, Washington. Port Gamble is a historic town that was owned and operated by P&T, formerly a related party, until 1985 when the townsite and other assets were spun off to the Partnership. P&T continued to operate the townsite until 1996 and leased the millsite at Port Gamble through January 2002, at which point P&T signed an agreement with the Partnership dividing the responsibility for environmental remediation of Port Gamble between the two parties. Under Washington law, both Pope Resources and P&T are "potentially liable persons" based on ownership and/or operation of the site. These laws provide for joint and several liability among parties owning or operating property on which contamination occurs, meaning that cleanup costs can be assessed against any or all such parties. Our agreement with P&T was intended to apportion responsibility based on this principle, with P&T bearing the larger share of responsibility based upon their role in operating the site and upon their relatively lengthy ownership.

However, P&T's financial condition has declined markedly in recent years, having first disclosed questions about its ability to continue as a going concern in its Annual Report on Form 10-K for the fiscal year ended December 31, 2006. Since that time we have closely monitored P&T's financial disclosures, including its repeated attempts to restructure its credit arrangements throughout the second and third quarters of 2007 and culminating in a late October 2007 bankruptcy filing in Canada, followed in November 2007 by a Chapter 11 bankruptcy filing in the United States. Since then, P&T has undertaken to sell substantially all of its assets. These actions raised substantial doubt in management's views as to whether P&T can meet all or any portion of its obligations under our settlement and remediation agreement.

Because of the joint and several liability that attends to the cleanup obligation, management has taken a number of steps to address our own exposure. First, as noted above, we have increased our remediation estimate by $1.9 million to reflect our current estimate of the remediation costs. Second, because we have increased our estimate of the potential costs on several occasions in the past, we have revised our methodology for assessing this liability, shifting to a "Monte Carlo simulation" analysis which we hope will improve our ability to predict the actual liability for the remaining cleanup. Third, we are in active discussions with the Washington State Department of Ecology to promote protection of the environment, optimize and appropriately allocate the remaining cleanup liabilities, and maximize our control over the remediation process. Finally, we are monitoring the P&T bankruptcy action as an unsecured creditor in an effort to maximize any potential recovery from P&T's remaining assets, although we have substantial doubt as to whether we will recoup any material portion of those assets because substantially all of P&T's assets are subject to the security interests of its lenders.

Management continues to monitor closely both the Port Gamble cleanup process and the P&T bankruptcy proceeding; however, in light of current circumstances our addition of $1.9 million to the remediation liability reflects what management believes to be the best estimate of the remaining cleanup cost based upon an estimation method that represents the most likely outcome.

PROPERTY DEVELOPMENT COSTS. The Partnership is developing several master planned communities with the Gig Harbor and Bremerton projects being the most notable currently. Costs of development, including interest, are capitalized for these projects and allocated to individual lots based upon their relative preconstruction value. This allocation of basis supports, in turn, the computation of those amounts reported as a current vs. long-term asset ("Land Held for Sale" and "Land Held for Development", respectively). As lot sales occur, the allocation of these costs becomes part of cost of sales attributed to individual lot sales. Costs associated with land including acquisition, project design, architectural costs, road construction, capitalized interest and utility installation are accounted for as investment activities (as opposed to an operating activity) on our statement of cash flows. These investments are often made for a number of years prior to the realization of revenue from the disposition of these properties. Cash generated from the sale of these properties is classified as an operating activity on our cash flow statement as the sale of these properties is the main operating activity of our Real Estate segment.

PERCENTAGE OF COMPLETION REVENUE RECOGNITION. The partnership accounts for revenue recognized from development sales consistent with Statement of Financial Accounting Standards No. 66, Accounting for Sales of Real Estate. When a real estate transaction is closed with significant outstanding obligations to complete infrastructure or other construction, revenue is recognized on a percentage of completion method by calculating a ratio of costs incurred to total costs expected. Revenue is deferred proportionately based on the remaining costs to complete the project.

CONSOLIDATED BALANCE SHEETS

Years ended December 31 (in thousands)	*2007*	*2006*
ASSETS		
Current assets:		
Cash and cash equivalents	**$2,174**	$7,194
Short-term investments	**30,775**	25,000
Accounts receivable	**442**	1,074
Land held for sale	**780**	2,813
Current portion of contracts receivable	**622**	4,547
Prepaid expenses and other	**252**	499
Total current assets	**35,045**	41,127
Properties and equipment, at cost:		
Land held for development	**21,159**	13,294
Land	**22,318**	22,327
Roads and timber, net of accumulated depletion of $48,418 and $43,461	**94,635**	98,110
Buildings and equipment, net of accumulated depreciation of $7,017 and $6,748	**3,577**	3,405
Total properties and equipment, at cost	**141,689**	137,136
Other assets:		
Contracts receivable, net of current portion	**1,420**	1,161
Other	**1,171**	858
Total other assets	**2,591**	2,019
Total assets	**$179,325**	$180,282
LIABILITIES AND PARTNERS' CAPITAL		
Current Liabilities:		
Accounts payable	**$1,371**	$1,114
Accrued liabilities	**2,112**	3,083
Current portion of environmental remediation	**250**	236
Current portion of long-term debt	**1,342**	1,342
Minority interest – IPMB	**3**	77
Deposits	**105**	85
Deferred revenue	**268**	8,838
Total current liabilities	**5,451**	14,775
Long-term debt	**29,385**	30,866
Minority interest – ORM Timber Fund I, LP	**45,803**	46,685
Environmental remediation	**1,744**	6
Other long-term liabilities	**298**	345
Commitments and contingencies		
Partners' capital (units outstanding: 4,663 and 4,647)	**96,644**	87,605
Total liabilities and partners' capital	**$179,325**	$180,282

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS

Years ended December 31 (in thousands, except per unit information)	***2007***	*2006*	*2005*
Revenue:			
Fee Timber	**$35,514**	$35,260	$44,424
Timberland Management & Consulting	**1,344**	3,670	7,764
Real Estate	**15,037**	27,320	4,818
Total revenue	**51,895**	66,250	57,006
Costs and expenses:			
Cost of sales:			
Fee Timber	**(15,837)**	(16,221)	(23,847)
Real Estate	**(4,625)**	(9,532)	(748)
Total cost of sales	**(20,462)**	(25,753)	(24,595)
Operating expenses:			
Fee Timber	**(4,462)**	(4,447)	(4,257)
Timberland Management & Consulting	**(2,227)**	(2,404)	(4,224)
Real Estate	**(3,371)**	(3,664)	(2,602)
Real Estate environmental remediation	**(1,878)**	(260)	(198)
General & Administrative (G&A)	**(4,782)**	(3,817)	(3,651)
Total operating expenses	**(16,720)**	(14,592)	(14,932)
Operating income (loss):			
Fee Timber	**15,215**	14,592	16,320
Timberland Management & Consulting	**(883)**	1,266	3,540
Real Estate	**5,163**	13,864	1,270
Unallocated G&A	**(4,782)**	(3,817)	(3,651)
Total operating income	**14,713**	25,905	17,479
Other income (expense):			
Interest expense	**(2,574)**	(2,691)	(2,879)
Interest capitalized to development projects	**1,145**	912	–
Interest income	**1,753**	1,154	402
Total other income (expense)	**324**	(625)	(2,477)
Income before income taxes and minority interest	**15,037**	25,280	15,002
Income tax benefit (expense)	**69**	(439)	(997)
Income before minority interest	**15,106**	24,841	14,005
Minority interest – ORM Timber Fund I, LP	**402**	146	–
Minority interest – IPMB	**–**	(77)	(321)
Net income	**$15,508**	$24,910	$13,684
Earnings per unit – basic	**$3.31**	$5.37	$2.97
Earnings per unit – diluted	**$3.21**	$5.23	$2.88
Distributions per unit	**$1.36**	$1.06	$0.80

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF PARTNERS' CAPITAL AND COMPREHENSIVE INCOME

Years ended December 31 (in thousands)	*General Partners*	*Limited Partners*	*Total*
December 31, 2004	$991	$53,542	$54,533
Net income and comprehensive income	178	13,506	13,684
Distributions	(48)	(3,653)	(3,701)
Equity based compensation	–	76	76
Proceeds from option exercises	–	1,813	1,813
December 31, 2005	$1,121	$65,284	$66,405
SAB 108 Adjustment	7	546	553
Adjusted January 1, 2006	$1,128	$65,830	$66,958
Net income and comprehensive income	322	24,588	24,910
Distributions	(64)	(4,897)	(4,961)
Equity based compensation	–	444	444
Proceeds from option exercises	–	254	254
December 31, 2006	$1,386	$86,219	$87,605
Net income and comprehensive income	**199**	**15,309**	**15,508**
Distributions	**(83)**	**(6,366)**	**(6,449)**
Equity based compensation	**–**	**624**	**624**
Unit repurchase	**–**	**(1,374)**	**(1,374)**
Proceeds from option exercises	**–**	**730**	**730**
December 31, 2007	**$1,502**	**$95,142**	**$96,644**

Weighted average units outstanding:	12/31/07	12/31/06	12/31/05
Basic	**4,680**	4,642	4,605
Diluted	**4,825**	4,762	4,753

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31 (in thousands)	***2007***	*2006*	*2005*
Cash flows from operating activities:			
Cash received from customers	**$47,667**	$69,548	$56,730
Cash paid to suppliers and employees	**(24,473)**	(25,030)	(25,232)
Interest received	**1,712**	1,095	377
Interest paid	**(2,585)**	(1,795)	(2,892)
Income taxes paid	**(340)**	(247)	(74)
Net cash provided by operating activities	**21,981**	43,571	28,909
Cash flows from investing activities:			
Capital expenditures	**(12,162)**	(12,177)	(6,756)
Proceeds from sale of fixed assets	**64**	–	6
Purchase of short–term investments	**(5,775)**	(10,000)	(15,000)
Timberland acquisition	**–**	(57,806)	–
Net cash used in investing activities	**(17,873)**	(79,983)	(21,750)
Cash flows from financing activities:			
Cash distributions to unitholders	**(6,449)**	(4,961)	(3,701)
Net draw (repayment) on line of credit	**–**	–	(758)
ORM Timber Fund I, LP capital contributions	**–**	46,831	–
ORM Timber Fund I, LP distributions	**(480)**	–	–
Unit repurchase	**(1,374)**	–	–
Repayment of long–term debt	**(1,481)**	(1,675)	(1,883)
Proceeds from option exercises	**730**	254	1,813
Minority interest distribution	**(74)**	(204)	(26)
Net cash provided by (used in) financing activities	**(9,128)**	40,245	(4,555)
Net increase (decrease) in cash and cash equivalents	**(5,020)**	3,833	2,604
Cash and cash equivalents:			
Beginning of year	**7,194**	3,361	757
End of year	**$2,174**	$7,194	$3,361

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

Years ended December 31 (in thousands)	*2007*	*2006*	*2005*
Reconciliation of net income to net cash provided by operating activities:			
Net income	**$15,508**	$24,910	$13,684
Cost of land sold	**3,854**	7,709	434
Minority interest–IPMB	**–**	77	321
Minority interest–ORM Timber Fund I, LP	**(402)**	(146)	–
Depreciation and amortization	**777**	712	640
Depletion	**4,772**	6,305	10,612
Deferred tax expense (benefit)	**13**	(16)	890
Equity based compensation	**624**	444	76
Increase (decrease) in cash from changes in operating accounts:			
Accounts receivable	**676**	(25)	71
Contracts receivable	**3,666**	(5,211)	267
Other current assets	**247**	(220)	(141)
Accounts payable and accrued liabilities	**(551)**	890	2,923
Environmental remediation	**1,753**	84	(316)
Deposits	**20**	27	81
Deferred revenue	**(8,570)**	8,534	(614)
Other long–term liabilities	**(47)**	133	(18)
Other long term assets	**(360)**	(636)	–
Other, net	**(1)**	–	(1)
Net cash provided by operating activities	**$21,979**	$43,571	$28,909

See accompanying notes to consolidated financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of operations:

Pope Resources, A Delaware Limited Partnership (the "Partnership") is a publicly traded limited partnership engaged primarily in managing timber resources on its own properties as well as those owned by others. Pope Resources' active subsidiaries include ORM, Inc., which is responsible for managing Pope Resources' timber properties; Olympic Resource Management LLC, which provides timberland management and consulting activities and is responsible for developing the timber fund business; Olympic Property Group I, LLC, which manages the Port Gamble town and millsites and land that is classified as development property; and OPG Properties LLC, which owns land that is held as development property. These consolidated financial statements also include ORM Timber Fund I, LP (the Fund). With respect to the Fund, Olympic Resource Management LLC is the general partner and owns 1% while Pope Resources owns 19%. The Fund's purpose is to invest in timberlands. See Note 2 for additional information.

The managing general partner of the Partnership is Pope MGP, Inc. The Partnership operates in three business segments: Fee Timber, Timberland Management & Consulting, and Real Estate. Fee Timber represents the growing and harvesting of trees from owned properties. Timberland Management & Consulting represents management, acquisition, disposition, and consulting services provided to third party owners of timberlands and provides management service to the Fund. Real Estate consists of obtaining entitlements for properties that have been identified as having value as developed residential or commercial property and operating the Partnership's existing commercial and residential properties in Kitsap and Pierce Counties, Washington.

Principles of consolidation:

The consolidated financial statements include the accounts of the Partnership and its subsidiaries. Intercompany balances and transactions have been eliminated in consolidation.

Minority interests:

Minority Interest – ORM Timber Fund I, LP represents the 80% interest in the Fund owned by third-party investors. The Fund is consolidated into Pope Resources' financial statements due to Olympic Resource Management LLC's role as General Partner of the Fund (see Note 2). Minority interest-IPMB represents Pope MGP, Inc.'s interest in the Investor Portfolio Management Business (IPMB) (see Note 10) and has been classified as a current liability since the minority interest's share in income is generally distributed on an annual basis.

Use of estimates in financial statements:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the reporting period. Actual results could differ from those estimates.

Cost of sales:

For statement of operations presentation, cost of sales consists of the Partnership's cost basis in timber, real estate, and other inventory sold, and direct costs incurred to make those assets saleable. Those direct costs include the expenditures associated with the harvesting and transporting of timber and closing costs incurred in land and lot sale transactions.

Concentration of credit risk:

Financial instruments that potentially subject the Partnership to concentrations of credit risk consist principally of accounts and contracts receivable. The Partnership limits its credit exposure by considering the creditworthiness of potential customers. The Partnership does not maintain an allowance for doubtful accounts, as losses from accounts receivable have historically been minimal.

Contracts receivable:

The Partnership sells land parcels under contracts requiring a minimum cash down payment of 20% and having financing terms of up to 15 years at interest rates between zero and 10% per annum. The Partnership reduces credit risk on contracts through down payment requirements and utilizing the underlying land as collateral.

At December 31, 2007, minimum principal payments on contracts receivable for the next five years and thereafter are due as follows (in thousands):

2008	$622
2009	35
2010	302
2011	32
2012	187
Thereafter	864

Income taxes:

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Operating loss and tax credit carryforwards are also factored into the calculation of deferred tax assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates that are expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Property, equipment, and roads:

Depreciation is provided using the straight-line method over the estimated useful lives of the assets, which range from 5 to 39 years. The Partnership capitalizes the cost of building permanent roads on the tree farms and expenses temporary roads and road maintenance. Capitalized roads are depleted as timber is harvested. The road depletion rate is calculated by dividing the cost of capitalized roads at the beginning of the year by merchantable timber inventory. The resulting rate is applied to timber harvested during the year to determine road depletion expense.

When facts and circumstances indicate the carrying value of properties may be impaired, an evaluation of recoverability is performed by comparing the carrying value of the property to the projected future undiscounted cash flows. Upon indication that the carrying value of such assets may not be recoverable, the Partnership would recognize an impairment loss, determined on the basis of fair market value, and charge this amount against current operations.

Buildings and equipment consist of the following as of December 31, 2007 and 2006 (in thousands):

Description	*12/31/2007*	*12/31/2006*
Buildings	**$7,257**	$6,825
Equipment	**2,763**	2,750
Furniture and fixtures	**574**	578
Total	**10,594**	10,153
Accumulated depreciation	**(7,017)**	(6,748)
Net buildings and equipment	**$3,577**	$3,405

Timber:

The depletion rate is calculated by dividing estimated merchantable timber inventory into the cost basis of merchantable inventory as of the beginning of the year. To calculate the depletion rate the Partnership uses a combined pool when the characteristics of the acquired timber are not significantly different from the Partnership's existing timberlands. Timber harvested by ORM Timber Fund I, LP is accounted for in a separate depletion pool due to the third-party owners in this Fund.

Land held for development or sale:

Land held for development represents the Partnership's cost basis in land that has been identified as having greater value as development than timber property. Our Real Estate segment works with these properties to establish entitlements with city and county officials that allow for further development. Project costs clearly associated with development or construction of these properties are capitalized. Indirect costs that do not clearly relate to projects under development or construction are expensed as incurred. Those properties that are either under contract or where the Partnership is planning to sell within the next 12 months are classified as a current asset under Land Held for Sale.

Deferred revenue:

Deferred revenue represents the unearned portion of revenue collected. The balance at December 31, 2007 of $268,000 represents the unearned portion of the amounts received on cell tower leases. The balance at December 31, 2006 includes $8.6 million for two real estate transactions. The Partnership deferred $7.2 million for one transaction due to the buyer's rescission clause surrounding the Partnership's obligation to complete certain infrastructure improvements which was fulfilled in 2007. An additional transaction in 2006 required deferral of $1.3 million of total revenue of $12.0 million since infrastructure improvement obligations under the sale agreement were not complete until December 31, 2007. The remainder of the balance at December 31, 2006 represents the unearned portion of the amounts received for cell tower leases.

Revenue recognition:

Revenue on timber sales is recorded when title and risk of loss passes to the buyer. Revenue on real estate sales is recorded on the date the sale closes, upon receipt of adequate down payment, and receipt of the buyer's obligation to make sufficient continuing payments towards the purchase of the property. The Partnership does not currently sell real estate with less than a 20% down payment. Management fees and consulting service revenue is recognized as the related services are provided.

Land sales:

The Partnership considers the sale of land to be part of its normal operations and therefore recognizes revenue from the sale and cost of sales for the Partnership's basis in the property sold. Cash generated from these sales is included in cash flow from operations on the Partnership's statements of cash flows. Investments to acquire timberlands, from which the sale of land with a higher or better use is made, and the costs incurred to develop those properties are reported in investing activities. These cash outflows are often made years prior to realization through sale of the property and, in many cases, the acquisition of the timberlands occurred prior to the requirement to include cash flow statements.

Equity based compensation:

Effective January 1, 2006, we adopted the provisions of Statement of Financial Accounting Standards No. 123 (revised 2004), *Share Based Payment* (SFAS No. 123R) using the modified prospective approach and accordingly have not restated prior period results. SFAS 123R established the accounting for equity instruments exchanged for employee services. Under SFAS 123R, share-based compensation cost is measured at the grant date based on the calculated fair value of the award. We have also changed our accounting for equity-based compensation awarded to retirement eligible directors and employees to amortize the expense of the award on a straight line basis over the lesser of the vesting period or the period between the grant date and eligibility for retirement.

Prior to the adoption of SFAS No. 123R, we accounted for equity based compensation granted to employees in accordance with Accounting Principles Board (APB) No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. In 2005, we adopted the 2005 Unit Incentive Plan. Following adoption of this new plan the Board of Directors began issuing restricted units instead of unit options as its primary method of granting equity based compensation. Units issued as a result of option exercises and restricted unit grants are funded through the issuance of new units. As of December 31, 2007, total compensation expense related to non-vested awards not yet recognized was $980,000 with a weighted average 28 months remaining to vest.

In addition to accounting and disclosure presented in accordance with APB No. 25, we also provided the disclosures required under SFAS No. 123, *Accounting for Stock Based Compensation* (SFAS No. 123) as amended by SFAS No. 148, *Accounting for Stock Based Compensation – Transition and Disclosures*. As a result, no expense was reflected in our net income for the period ended December 31, 2005 for unit options, as all options granted had an exercise price equal to the market value of the underlying units on the grant date.

The following table reflects our proforma net income per unit for 2005 had compensation for unit options been determined based on the fair value at the grant date, consistent with the methodology prescribed under SFAS No. 123:

(In thousands except per unit data)	Year Ended December 31, 2005
Net income as reported	$13,684
Add back employee units based compensation expense recognized	76
Subtract proforma compensation expense under SFAS No. 123	(218)
Proforma net income under SFAS No. 123	$13,542
Earnings per unit as reported:	
Basic	$2.97
Diluted	$2.88
Proforma:	
Basic	$2.94
Diluted	$2.85

No unit options were granted in 2007 or 2006. For unit options granted in 2005, grant date fair values were determined based upon the following:

	Year Ended December 31, 2005
Expected life	5 years
Risk free interest rate	4.00% – 4.56%
Dividend yield	1.2% – 2.3%
Volatility	25.0% – 31.7%
Weighted average value	$8.59

Comprehensive income:

Comprehensive income consists of net income. The Consolidated Statements of Partners' Capital and Comprehensive Income contain the disclosure and calculation of comprehensive income.

Income per partnership unit:

Basic income per partnership unit is computed using the weighted average number of units outstanding during each year. Diluted income per unit is calculated using the weighted average units outstanding during the year, plus the dilutive impact of unit options outstanding. Unit options are excluded from the computation if their effect is anti-dilutive. There were no anti-dilutive unit options in 2007. In 2006 and 2005 1,100 unit options outstanding were not included in the calculation of earnings per partnership units as they were anti-dilutive.

	Year Ended December 31,		
	2007	2006	2005
Weighted average units outstanding (in thousands):			
Basic	**4,680**	4,642	4,605
Dilutive effect of unit options	**145**	120	148
Diluted	**4,825**	4,762	4,753

Statements of cash flows:

The Partnership considers all highly liquid debt instruments with maturity of three months or less when purchased to be cash equivalents.

2. ORM TIMBER FUND I, LP (THE FUND)

ORM Timber Fund I, LP (the Fund) was formed by Olympic Resource Management LLC (ORMLLC) for the purpose of attracting investor capital to purchase timberlands. The Fund was organized as a limited partnership where the general partner is ORMLLC. The objective of the Fund is to generate a return on investments through the acquisition, management, value enhancement and sale of timberland properties. The Fund will operate for a term of ten years from the end of the drawdown period which ended on August 1, 2007.

Pope Resources and ORMLLC own 20% of the Fund which is consolidated into the Partnership's financial statements. The Fund's statement of operations for the years ended December 31, 2007 and 2006 consist of a loss of $516,000 and $169,000, respectively. These losses include management fees paid to ORMLLC of $896,000 and $117,000 for 2007 and 2006, respectively, which are eliminated in consolidation. Operating income of the Fund is generated primarily through the sale of logs and other forest products. The Fund commenced harvest activities in March 2007 and harvested 5.3 MMBF during 2007.

The Partnership's consolidated financial statements include the Fund's assets and liabilities at December 31, 2007 and 2006 which are as follows:

	2007	*2006*
Current assets	**$550**	$778
Timber, land, and roads (net of $1,269 and $- accumulated depletion)	**56,863**	57,803
Total assets	**$57,413**	$58,581
Current liabilities	**$159**	$224
Members' capital	**57,254**	58,357
Total liabilities and members' capital	**$57,413**	$58,581

3. LONG-TERM DEBT

Long-term debt at December 31 consists of (in thousands):

	2007	*2006*
Mortgage note payable to an insurance company, with interest at 9.65%, collateralized by timberlands, with monthly interest payments and annual principal payments maturing April 2011	**$9,559**	$10,099
Mortgage note payable to an insurance company, with interest at 7.63%, collateralized by timberlands, with monthly interest payments and annual principal payments maturing April 2011	**20,804**	21,555
Local improvement district assessments, with interest ranging from 5.03% to 6.5%, due through 2013	**364**	554
	30,727	32,208
Less current portion	**(1,342)**	(1,342)
Total long-term debt	**$29,385**	$30,866

The Partnership's debt agreements contain covenants which require the Partnership to maintain a required debt service coverage ratio and a debt to market capitalization ratio. As of December 31, 2007, the Partnership was in compliance with its debt covenants.

At December 31, 2007, principal payments on long-term debt for the next five years and thereafter are due as follows (in thousands):

2008	$ 1,342
2009	1,342
2010	1,342
2011	26,546
2012	155
Thereafter	0

4. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Partnership's financial instruments include cash and cash equivalents, short-term investments, accounts receivable, contracts receivable, accounts payable, and accrued liabilities, for which the carrying amount of each approximates fair value based on current market interest rates or their short-term nature. The fair value of fixed rate debt having a carrying value of $30.7 million and $32.2 million has been estimated based on current interest rates for similar financial instruments to be approximately $32.5 million and $33.7 million as of December 31, 2007 and 2006, respectively.

5. INCOME TAXES

The Partnership is not subject to income taxes. Instead, partners are taxed on their share of the Partnership's taxable income, whether or not cash distributions are paid. However, the Partnership's taxable subsidiaries are subject to income taxes. The following tables provide information on the impact of income taxes in those taxable subsidiaries. Consolidated Partnership earnings are reconciled to earnings before income taxes in taxable subsidiaries for the years ended December 31 as follows:

(000's)	*2007*	*2006*	*2005*
Consolidated Partnership income before income taxes (less minority interest)	**$15,439**	$25,349	$14,681
Less: Income earned in entities that pass-through pre-tax earnings to the partners	**15,867**	24,134	12,006
Income (loss) subject to income taxes	**$(428)**	$1,215	$2,675

The provision for income taxes relating to taxable subsidiaries of the Partnership consists of the following income tax benefit (expense) for the years ended December 31:

(000's)	*2007*	*2006*	*2005*
Current	**$82**	$(455)	$(107)
Deferred	**(13)**	16	(890)
Total	**$69**	$(439)	$(997)

A reconciliation between the federal statutory tax rate and the Partnership's effective tax rate is as follows for the years ended December 31:

	2007	2006	2005
Statutory tax on income	**34%**	34%	34%
Income (loss) earned in entities that pass-through pre-tax earnings to the partners	**(34%)**	(32%)	(27%)
Effective income tax rate	**–%**	2%	7%

The net deferred income tax assets include the following components as of December 31:

(000's)	**2007**	2006
Current (included in prepaid expenses and other)	**$52**	$50
Non current (included in other assets)	**67**	82
Total	**$119**	$132

The deferred tax assets are comprised of the following:

(000's)	**2007**	2006
Employee-related accruals	**$17**	$50
Depreciation	**67**	17
Other	**35**	65
	$119	$132

6. UNIT INCENTIVE PLAN

The Partnership's 2005 Unit Incentive Plan (New Plan) authorized the granting of nonqualified equity compensation to employees, officers, and directors of the Partnership. A total of 1,105,815 units have been reserved for issuance under the New Plan of which there are 1,056,167 units authorized but unissued as of December 31, 2007. The Partnership issued 19,500 restricted units under the New Plan in 2007. These units vest over four years with 50% vesting after three years and the remaining 50% vesting after the fourth year from date of grant provided the grantee is still an employee as of the vesting date. The grantee may not transfer restricted units until the holder fulfills the vesting requirements, which last for four years.

Restricted Units:

Pope Resources changed the primary form of equity compensation from unit options to restricted units upon adoption of the New Plan. The Human Resources Committee makes awards of restricted units to directors and senior managers of the Partnership and its subsidiaries. The restricted unit grants ordinarily vest over four years and are compensatory in nature. Restricted unit awards entitle the recipient to full distribution rights during the vesting period but are restricted from disposition and may be forfeited until the units vest. The fair value, which equals the market price at date of grant, is charged to income on a straight line basis over the vesting period.

Restricted unit activity for the three years ended December 31, 2007 was as follows:

	Units	*Weighted Average Grant Date Fair Value ($)*
Outstanding at December 31, 2005	20,000	33.44
Grants	19,000	34.75
Delivered	(750)	33.44
Forfeited	(1,500)	33.44
Outstanding at December 31, 2006	36,750	34.10
Grants	19,500	43.20
Delivered	(448)	35.69
Surrendered for payment of tax withholding	(188)	35.69
Forfeited	(2,364)	37.54
Outstanding at December 31, 2007	**53,250**	**37.27**

Unit Options:

Unit options have not been granted since December 2005. Units options granted prior to January 1, 2006 were non-qualified options granted at an exercise price not less than 100% of the fair value on the grant date. Unit options granted to employees vested over four or five years. Board members had the option of receiving their annual retainer in the form of unit options and those options vested immediately as they were granted monthly for services rendered during the month. Options granted have a life of ten years.

	Options	*Price ($)*
Vested at December 31, 2004	233,441	15.65
Unvested at December 31, 2004	130,250	18.61
Outstanding at December 31, 2004	363,691	16.71
Exercised	(87,779)	20.66
Granted	2,100	32.51
Vested	56,820	27.28
Vested at December 31, 2005	200,482	16.57
Unvested at December 31, 2005	77,530	13.02
Outstanding at December 31, 2005	278,012	15.58
Forfeitures	(4,800)	12.00
Exercised	(19,750)	12.86
Vested	33,012	13.12
Vested at December 31, 2006	213,744	16.38
Unvested at December 31, 2006	39,718	13.06
Outstanding at December 31, 2006	253,462	15.86
Exercised	(47,406)	15.40
Vested	33,518	12.52
Vested at December 31, 2007	**199,856**	**15.97**
Unvested at December 31, 2007	**6,200**	**15.96**
Outstanding at December 31, 2007	**206,056**	**15.97**

The aggregate spread between the option exercise price and unit market price (intrinsic value) of all options outstanding at December 31, 2007 was $5.5 million. The aggregate intrinsic value of all exercisable options at December 31, 2007 was $5.3 million. The total intrinsic value of options exercised during 2007 was $1,305,000. The weighted average remaining contractual term for all outstanding and exercisable options at December 31, 2007 was 4.2 years.

There were 1,085,815, 1,073,115 and 1,056,167 units available for issuance under the 2005 Unit Incentive Plan as of December 31, 2005, December 31, 2006, and December 31, 2007 respectively.

7. PARTNERSHIP UNIT REPURCHASE PLAN

The Partnership adopted a unit repurchase plan in October 2007. Under the plan the Partnership may repurchase limited partner units having an aggregate value of not more than $5,000,000. The unit repurchase period commenced November 1, 2007 and may continue for up to one year. In the fourth quarter of 2007 we purchased 31,656 units for an average cost per unit of $43.41 per unit.

8. EMPLOYEE BENEFITS

As of December 31, 2007 all employees of the Partnership and its subsidiaries are eligible to receive benefits under a defined contribution plan. During the years 2005 through 2007 the Partnership matched 50% of employees' contributions up to 8% of an individual's compensation. The Partnership's contributions to the plan amounted to $151,000, $130,000, $116,000, for the years ended December 31, 2007, 2006, and 2005 respectively.

9. COMMITMENTS AND CONTINGENCIES

Environmental remediation:

The Partnership has an accrual for estimated environmental remediation costs of $1,994,000 and $242,000 as of December 31, 2007 and 2006, respectively. This accrual represents estimated payments to be made to remedy environmental contamination at the historic Port Gamble, Washington, town and mill site and to monitor results of the cleanup efforts. This contamination is believed to have occurred during the years P&T operated a mill at Port Gamble, from 1853 to 1995. At the time Pope Resources was spun off from P&T, Port Gamble was included in our assets, and after contamination was discovered at the town site, mill site, and in the adjacent bay, we entered into a settlement and remediation agreement with P&T pursuant to which we and P&T allocated responsibility for cleanup costs. Under Washington law, both Pope Resources and P&T are "potentially liable persons" based on ownership and/or operation of the site. These laws provide for joint and several liability among parties owning or operating property on which contamination occurs, meaning that cleanup costs can be assessed against any or all such parties. Our agreement with P&T was intended to apportion responsibility based on this principle, with P&T bearing the larger share of responsibility based upon their role in operating the site and upon their relatively lengthy ownership.

P&T's financial condition has declined markedly in recent years, having first disclosed questions about its ability to continue as a going concern in its Annual Report on Form 10-K for the fiscal year ended December 31, 2006. Since that time we have closely monitored P&T's financial disclosures, including its repeated attempts to restructure its credit arrangements throughout the second and third quarters of 2007 and culminating in a late October 2007 bankruptcy filing in Canada, followed in November 2007 by a Chapter 11 bankruptcy filing in the United States. Since then, P&T has undertaken to sell substantially all of its assets. These actions raised substantial doubt in management's views as to whether P&T can meet all or any portion of its obligations under our settlement and remediation agreement. Because of the joint and several liability that attends to the cleanup obligation, management has taken a number of steps to address our own exposure. First, as noted above, we have increased our remediation estimate by $1.9 million to reflect our current estimate of the remediation costs. Second, because we have increased our estimate of the potential costs on several occasions in the past, we have revised our methodology for assessing this liability, shifting to a "Monte Carlo simulation" analysis which we hope will improve our ability to predict the actual liability for the remaining cleanup. Third, we are in active discussions with the Washington State Department of Ecology to promote protection of the environment, optimize and appropriately allocate the remaining cleanup liabilities, and maximize our control over the remediation process. Finally, we are monitoring the P&T bankruptcy action as an unsecured creditor in an effort to maximize any potential recovery from P&T's remaining assets, although we have substantial doubt as to whether we will recoup any material portion of those assets because substantially all of P&T's assets are subject to the security interests of its lenders.

Performance bonds:

In the ordinary course of business, and as part of the entitlement and development process, the Partnership is required to provide performance bonds to ensure completion of certain public facilities. The Partnership had performance bonds of $4,995,000 and $6,266,000 outstanding at December 31, 2007 and 2006, respectively.

Operating leases:

The Partnership has non-cancelable operating leases for automobiles, office space, and computer equipment. The lease terms are from 12 to 48 months. Rent expense under the operating leases totaled $124,000, $115,000, and $111,000 for the years ended December 31, 2007, 2006 and 2005, respectively.

At December 31, 2007 future annual minimum rental payments under non-cancelable operating leases are as follows:

Year	*Amount*
2008	$67,000
2009	9,000
2010	3,000
2011	2,000

Supplemental Employee Retirement Plan:

The Partnership has a supplemental employee retirement plan for a retired key employee. The plan provides for a retirement income of 70% of his base salary at retirement after taking into account both 401(k) and Social Security benefits with a fixed payment set at $25,013 annually. The Partnership accrued $19,000 and $23,000 in 2007 and 2006, respectively, for this benefit based on an approximation of the cost of purchasing a life annuity paying the aforementioned benefit amount.

The balance of the projected liability as of December 31, 2007 and 2006 was $204,000 and $210,000, respectively.

Contingencies:

The Partnership may from time-to-time be a defendant in various lawsuits arising in the ordinary course of business. Management believes Partnership losses related to such lawsuits, if any, will not have a material adverse effect to the Partnership's consolidated financial condition or results of operations or cash flows.

10. RELATED PARTY TRANSACTIONS AND MINORITY INTEREST

Pope MGP, Inc. is the managing general partner of the Partnership and receives an annual management fee of $150,000.

The minority interest-IPMB represents Pope MGP, Inc.'s profit-sharing interest in the IPMB. The 1997 amendment to the Limited Partnership Agreement authorizing management to pursue the IPMB specifies that annual net income from the IPMB will be split using a sliding scale allocation method, commencing with 80% to ORM, Inc., a subsidiary of Pope Resources, and 20% to Pope MGP, Inc. The sliding scale allocation method will allocate income evenly between ORM, Inc. and Pope MGP, Inc. once net income from the IPMB reaches $7.0 million in a fiscal year. The share of IPMB allocated to Pope MGP is further split between Pope MGP and a management incentive plan referred to as the Long-term Incentive Plan. This portion of Pope MGP's share of the IPMB is $0 in 2007 and $77,000 in 2006 and is included in Timberland Management & Consulting operating expenses. The aforementioned amendment authorizing pursuit of the IPMB limits cumulative net expenditures to $5.0 million. As of December 31, 2007, cumulative revenue from the IPMB exceeds cumulative IPMB expenditures.

11. SEGMENT AND MAJOR CUSTOMER INFORMATION

The Partnership's operations are classified into three segments: Fee Timber, Timberland Management & Consulting, and Real Estate. The Fee Timber segment consists of the harvest and sale of timber from the Partnership's 113,000 acres of fee timberland in Washington State.

The Timberland Management & Consulting segment began providing management, disposition, and technical forestry services to a client owning approximately 292,000 acres of timberland for this client and an additional 24,000 acres for the Fund.

The Real Estate segment's operations consist of management of development properties, and the rental of residential and commercial properties in Port Gamble and Kingston, Washington. Real Estate is working with nearly 2,600 acres of early stage development properties as of December 31, 2007. All of the Partnership's real estate activities are in Washington State.

For the year ended December 31, 2007, the Partnership had one major customer that represented 14% of consolidated revenue. For the year ended December 31, 2006, the Partnership had three major customers that represented 16%, 16% and 12% of consolidated revenue, respectively.

Identifiable assets are those used exclusively in the operations of each industry segment or those allocated when used jointly. The Partnership does not allocate cash, accounts receivable, certain prepaid expenses, or the cost basis of the Partnership's administrative office for purposes of evaluating segment performance. Inter-segment transactions are valued at prices that approximate the price that would be charged to a major third-party customer.

Details of the Partnership's operations by business segment for the years ended December 31 were as follows (in thousands):

	2007	*2006*	*2005*
Revenue:			
Pope Resources Fee Timber	**32,678**	35,905	44,427
Timber Fund	**3,008**	–	–
Total Fee Timber	**35,686**	35,905	44,427
Timberland Management & Consulting	**2,260**	3,860	7,786
Real Estate	**15,076**	27,356	4,854
Total Revenue (Internal)	**53,022**	67,121	57,067
Elimination of Intersegment Revenue	**(1,127)**	(871)	(61)
Total Revenue (External)	**51,895**	66,250	57,006
Intersegment Revenue or Transfers			
Pope Resources Fee Timber	**(172)**	(645)	(3)
Timber Fund	**–**	–	–
Total Fee Timber	**(172)**	(645)	(3)
Timberland Management & Consulting	**(916)**	(190)	(22)
Real Estate	**(39)**	(36)	(36)
Total	**(1,127)**	(871)	(61)

	2007	2006	2005
Operating Income:			
Pope Resources Fee Timber	**14,957**	15,230	16,290
Timber Fund	**(490)**	(183)	–
Total Fee Timber	**14,467**	15,047	16,290
Timberland Management			
& Consulting	**(174)**	1,419	3,538
Real Estate	**5,202**	13,255	1,302
G&A	**(4,782)**	(3,816)	(3,651)
Total Operating Income	**14,713**	25,905	17,479
Total Operating Income (External)	**14,713**	25,905	17,479
Intersegment Charges or Transfers			
Pope Resources Fee Timber	**(133)**	(585)	30
Timber Fund	**882**	130	–
Total Fee Timber	**749**	(455)	30
Timberland Management			
& Consulting	**(787)**	(153)	2
Real Estate	**39**	609	(32)
G&A	**(1)**	(1)	–
Total	**–**	–	–

	2007	2006	2005
Depreciation, Amortization and Depletion			
Pope Resources Fee Timber	**3,835**	6,266	10,714
Timber Fund	**1,269**	–	–
Total Fee Timber	**5,104**	6,266	10,714
Timberland Management			
& Consulting	**81**	73	97
Real Estate	**201**	647	178
G&A	**185**	218	263
Total	**5,571**	7,204	11,252

	2007	2006	2005
Assets			
Pope Resources Fee Timber	**63,759**	65,304	73,024
Timber Fund	**57,412**	58,581	–
Total Fee Timber	**121,171**	123,885	73,024
Timberland Management			
& Consulting	**669**	690	174
Real Estate	**21,940**	16,107	14,031
G&A	**35,725**	39,600	19,129
Total	**179,505**	180,282	106,358

	2007	2006	2005
Capital and Land Expenditures			
Pope Resources Fee Timber	**1,172**	1,138	1,159
Timber Fund	**329**	57,806	–
Total Fee Timber	**1,501**	58,944	1,159
Timberland Management			
& Consulting	**105**	2	133
Real Estate	**10,164**	10,919	5,400
G&A	**392**	118	64
Total	**12,162**	69,983	6,756

	2007	2006	2005
Revenue of forest products			
Domestic forest products	**31,908**	31,486	38,972
Export forest products, indirect	**1,584**	1,808	3,784
Fees for service	**4,348**	6,638	10,352
Homes, lots, and			
undeveloped acreage	**14,055**	26,318	3,898
Total	**51,895**	66,250	57,006

12. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

(in thousands except per unit amounts)	*Revenue*	*Income From Operations*	*Net Income*	*Earnings Per Partnership Unit Basic*	*Earnings Per Partnership Unit Diluted*
2007					
First quarter	**$6,787**	**$688**	**$854**	**$0.18**	**$0.18**
Second quarter	**15,326**	**4,952**	**4,815**	**1.03**	**1.00**
Third quarter	**12,171**	**3,228**	**3,551**	**0.76**	**0.74**
Fourth quarter	**17,611**	**5,845**	**6,288**	**1.34**	**1.30**
2006					
First quarter	$16,083	$6,180	$5,298	$1.14	$1.11
Second quarter	15,610	3,740	3,540	0.77	0.75
Third quarter	18,024	8,403	8,279	1.78	1.74
Fourth quarter	16,533	7,582	7,793	1.68	1.63

13. SUBSEQUENT EVENTS

The Partnership has historically invested cash that is not required to fund immediate cash needs in a combination of money market accounts and AAA-rated student loan auction rate securities (SLARS). These SLARS are private placement securities with nominal long-term maturities for which the interest rates are reset every 28 days through a Dutch auction. Prior to each reset date, holders of the security have a choice to either liquidate their interest in the security or retain the security and obtain the new interest rate set by the auction. The Partnership invests in SLARS that are almost exclusively originated under the Federal Family Education Loan Program (FFELP) because FFELP loans are reinsured by the U.S. Department of Education for at least 97% of defaulted principal and interest.

In February 2008, auctions for these SLARS began to fail, with auction failure occurring when the level of bidders for the security is insufficient to provide liquidity for those investors that want to exit the investment. The interest rate paid when an auction fails is referred to as the default rate and is set by the underlying finance documents agreed to by the debt issuer.

As of February 29, 2008, the Partnership currently holds $17 million in SLARS and all of these securities have been through at least one successful reset in 2008. As we have moved deeper into the first quarter of 2008, however, $16 million of these securities have now been through one reset date with a failed auction result and are now paying interest at a default interest rate. The default interest rate is set according to terms of the SLARS legal documents and is typically a spread to LIBOR, or a Treasury index. However, the default rate can also be a fixed number or a state regulated cap. Where the SLARS in our portfolio have been through an auction failure, the vast majority have default rates pegged to 150 basis points over LIBOR. One is pegged to Treasuries and the one with a double-digit rate is governed by a state regulated cap. The following table provides a listing of our SLARS portfolio by issuer, interest rate, and maturity, with the latter ranging between 24 and 38 years. Management recognizes the need to evaluate at its next quarterly balance sheet date whether the failed auctions indicate impairment in value based on the facts available at that time.

Issuer of Security	*Rate* (1)	*Reset Date* (2)	*Maturity*	*Position (millions)*
Pennsylvania State Higher Education Assistance	4.600%	3/10/2008	12/1/2045	$ 1.00
Pennsylvania State Higher Education Assistance	10.530%	3/18/2008	5/1/2046	1.00
Federated Student Finance Corporation	4.618%	3/19/2008	6/1/2041	1.00
Brazos Higher Education Authority, Inc.	4.635%	3/20/2008	12/1/2042	1.00
Connecticut Student Loan Foundation	4.624%	3/24/2008	6/1/2034	1.00
Brazos Higher Education Authority, Inc.	4.625%	3/25/2008	6/25/2042	1.00
Brazos Student Finance Corporation	4.625%	3/25/2008	7/16/2038	1.00
Brazos Student Finance Corporation	4.619%	3/27/2008	4/2/2040	0.95
Collegiate Funding Services Education Loan	4.619%	3/27/2008	12/28/2043	1.00
Missouri Higher Education Loan Authority	3.880%	3/27/2008	9/1/2043	1.00
NELNET Education Loan Funding	4.619%	3/27/2008	7/25/2043	1.00
Student Loan Marketing Association	4.619%	3/27/2008	3/15/2028	1.00
Student Loan Marketing Association	4.611%	3/28/2008	1/25/2042	1.00
Brazos Higher Education Authority, Inc.	4.580%	4/1/2008	12/1/2042	1.00
Missouri Higher Ed Loan	1.915%	4/1/2008	5/1/2044	1.00
North Carolina State Education Assistance Authority	5.105%	4/1/2008	7/1/2032	1.00
Panhandle Plains Texas Higher Education Authority	4.575%	4/2/2008	6/1/2036	1.00
Total				$16.95

(1) With the exception of the security issued by Pennsylvania State Higher Education Assistance with a reset date of 3/10/2008, all these rates are default rates set as a result of failed auctions.

(2) Reset dates shown are the date of the next auction for each security.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Unitholders

POPE RESOURCES, A DELAWARE LIMITED PARTNERSHIP

We have audited the accompanying consolidated balance sheets of Pope Resources, A Delaware Limited Partnership, and subsidiaries (collectively, the Partnership) as of December 31, 2007 and 2006, and the related consolidated statements of operations, partners' capital and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2007. These consolidated financial statements are the responsibility of the Partnership's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Pope Resources, A Delaware Limited Partnership, and subsidiaries as of December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles.

Effective January 1, 2006, the Partnership adopted Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment" and Securities and Exchange Commission Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in the Current Year Financial Statements."

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Partnership's internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee for Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 5, 2008 expressed an unqualified opinion on the effectiveness of internal control over financial reporting.

KPMG LLP

KPMG LLP
Seattle, Washington
March 5, 2008

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Unitholders

POPE RESOURCES, A DELAWARE LIMITED PARTNERSHIP

We have audited Pope Resources, A Delaware Limited Partnership, internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Partnership's management is responsible for maintaining effective internal control over financial reporting and its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control Over Financial Reporting in the Partnership's 10-K for the year ended December 31, 2007. Our responsibility is to express an opinion on the Partnership's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Pope Resources, A Delaware Limited Partnership, maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Pope Resources, A Delaware Limited Partnership, and subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of operations, partners' capital and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2007, and our report dated March 5, 2008 expressed an unqualified opinion on those consolidated financial statements.

KPMG LLP

KPMG LLP
Seattle, Washington
March 5, 2008

RESULTS OF OPERATIONS

(Dollar amounts are in thousands except per unit data)	***2007***	*2006*	*2005*	*2004*	*2003*	*2002*
Revenue						
Fee Timber	**$35,514**	$35,260	$44,424	$33,571	$22,916	$23,298
Timberland Management & Consulting	**1,344**	3,670	7,764	1,601	2,386	7,295
Real Estate	**15,037**	27,320	4,818	4,476	1,734	1,599
Total revenue	**51,895**	66,250	57,006	39,648	27,036	32,192
Operating income/(loss)						
Fee Timber	**15,216**	14,592	16,320	15,126	9,669	10,199
Timberland Management & Consulting	**(961)**	1,266	3,540	(598)	272	919
Real Estate	**5,241**	13,864	1,270	1,586	(476)	(1,667)
General & Administrative	**(4,783)**	(3,817)	(3,651)	(2,986)	(2,842)	(3,864)
Total operating income/(loss)	**14,713**	25,905	17,479	13,128	6,623	5,587
Depreciation, depletion, and amortization	**5,549**	7,017	11,252	5,752	3,546	3,864
Net interest expense/(income)	**(324)**	625	2,477	2,952	2,806	2,894
Income tax expense/(benefit)	**(69)**	439	997	–	242	(788)
Minority interests	**(402)**	(69)	321	–	47	147
Net income/(loss)	**15,508**	24,910	13,684	10,176	3,528	3,334
PER UNIT RESULTS						
Net income/(loss) per diluted unit	**$3.21**	$5.23	$2.88	$2.22	$0.78	$0.74
Distributions	**1.36**	1.06	0.80	0.44	0.24	0.10
Partners' capital	**20.73**	18.85	14.35	12.01	10.19	9.65
Weighted average units outstanding (000) – diluted	**4,825**	4,762	4,753	4,594	4,522	4,520
CASH FLOW						
Net cash provided by operating activities	**$21,981**	$43,571	$28,909	$17,854	$8,641	$9,005
Investing activities (excluding short-term investments)	**12,098**	69,983	6,750	24,500	2,000	1,676
Distributions to unitholders	**6,449**	4,961	3,701	1,989	1,084	452
Unit repurchases	**1,374**					
Payment/(issuance) of long-term debt	**1,481**	1,675	1,883	1,979	1,662	1,110
Free cash flow #	**11,268**	26,080*	16,731	10,898*	3,595	4,119
FINANCIAL POSITION						
Land and timber, net of depletion	**$138,112**	$133,731	$78,222	$87,517	$69,003	$70,495
Total assets	**179,325**	180,282	106,358	94,868	86,308	86,788
Long-term debt, including current portion	**30,727**	32,208	33,883	35,766	37,745	39,239
Partners' capital	**96,644**	87,605	66,405	54,533	46,036	43,598
FINANCIAL RATIOS #						
Total Debt to Total Capitalization	**24%**	27%	34%	40%	45%	47%
Return on Assets	**9%**	17%	14%	11%	4%	4%
Return on Equity	**17%**	32%	23%	20%	8%	8%
UNIT TRADING PRICES #						
High	**$50.01**	$36.00	$56.85	$25.25	$15.99	$15.50
Low	**34.25**	30.00	19.35	15.00	7.00	9.30
Year-end close	**42.75**	34.32	31.02	25.00	15.43	10.11
Enterprise value (year end – $millions)	**197**	159	159	148	97	78
Fee timber harvest (MMBF)	**55.1**	54.5	74.2	60.3	45.0	45.1

* *Timberland acquisitions and timber fund co-investments are excluded from the calculation of free cash flow.*
\# *Unaudited*

2001	2000	1999	1998	1997
$24,999	$21,444	$23,467	$20,985	$19,694
9,703	11,011	11,705	8,906	–
13,143	18,202	15,681	13,061	10,415
47,845	50,657	50,853	42,952	30,109
9,190	12,113	13,020	11,560	10,151
1,685	152	1,877	3,224	–
(2,709)	(10,888)	(95)	2,527	(727)
(5,110)	(7,254)	(8,122)	(6,948)	(4,570)
3,056	(5,877)	6,680	10,363	4,854
7,698	2,899	2,683	2,053	1,647
2,961	700	1,039	788	1,008
356	(326)	259	310	–
171	–	316	256	–
(432)	(6,251)	5,066	8,792	3,509
$(0.10)	$(1.38)	$1.11	$1.94	$0.78
–	0.40	0.40	0.40	0.49
8.98	9.12	10.91	10.16	8.61
4,526	4,528	4,548	4,534	4,526
$11,237	$9,973	$8,347	$9,152	$5,820
46,392	2,539	3,764	5,582	3,515
–	1,811	1,810	2,260	1,763
(26,540)	424	497	2,594	333
2,588*	(6,603)	5,983	3,805	2,069
$71,549	$25,411	$28,002	$27,973	$26,095
84,187	60,857	66,880	62,706	56,319
39,667	13,127	13,688	14,200	14,674
40,673	41,280	49,302	45,896	38,911
49%	24%	22%	24%	27%
–1%	–10%	8%	15%	6%
–1%	–14%	11%	21%	9%
$24.50	$25.75	$35.00	$32.50	$31.00
14.00	18.88	27.88	24.06	17.40
14.75	24.50	29.25	32.50	30.00
105	114	141	158	147
36.3	37.3	42.0	38.9	33.2

Definitions

Free Cash Flow
Net income plus depreciation, depletion, and cost of land sold less principal payments and capital expenditures excluding timberland acquisitions

Total Debt to Total Capitalization
Long-term debt plus current portion of long-term debt divided by total debt plus partners' capital

Return on Assets
Net income divided by the average of beginning and ending total assets

Return on Equity
Net income divided by the average of beginning and ending partners' capital

Weighted Average Units Outstanding
Weighted average units outstanding for the year plus the effect of dilutive unit options outstanding

Enterprise Value
Market capitalization less cash plus total debt outstanding

UNITHOLDER INFORMATION

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Vice President and Chief Financial Officer

Stock Exchange Listing

Pope Resources' units trade on the NASDAQ Global Select Market® under the symbol POPE.

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Annual Meeting

No annual meeting is required for the partnership.

Form 10-K

This report and Pope Resources' Report on Form 10-K are available on the Partnership's website (www.poperesources.com) by clicking on "Investor Relations" and then scrolling to either "Financial Information" or "SEC Filings" on the left-side navigation bar. Additionally, copies of this report and the Form 10-K are available without charge upon request to:

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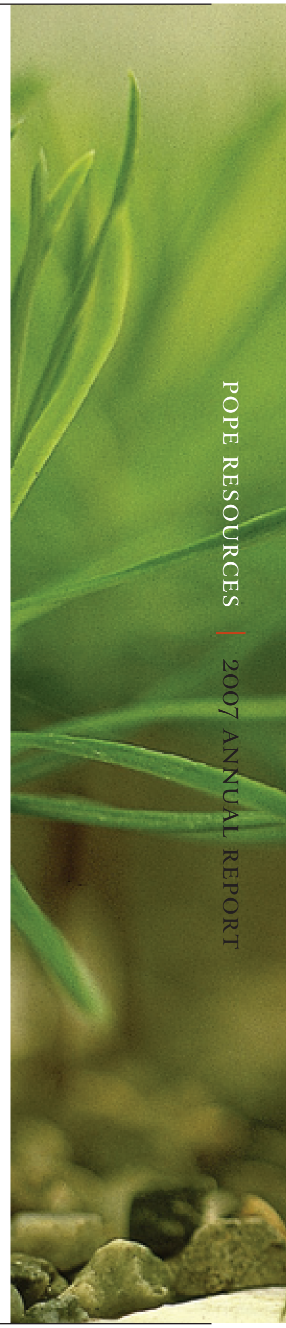

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