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RYN - Q3 2014 Rayonier Inc Earnings Call

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OVERVIEW:

Co. reported 3Q14 sales of $150m and net income attributable to Co. of $33m.

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CORPORATE PARTICIPANTS

Ed Kiker *Rayonier Inc. - SVP & CFO*

Dave Nunes *Rayonier Inc. - President & CEO*

Doug Long *Rayonier Inc. - VP of US Operations*

Chris Corr *Rayonier Inc. - SVP of Real Estate*

CONFERENCE CALL PARTICIPANTS

Mike Roxland *BofA Merrill Lynch - Analyst*

Paul Quinn *RBC Capital Markets - Analyst*

Collin Mings *Raymond James & Associates, Inc. - Analyst*

Mark Weintraub *Buckingham Research Group - Analyst*

Steve Chercover *D.A. Davidson & Co. - Analyst*

Chip Dillon *Vertical Research Partners - Analyst*

PRESENTATION

Operator

Welcome and thank you for joining Rayonier's third-quarter 2014 teleconference call.

(Operator Instructions)

Today's conference is being recorded. If you have any objections you may disconnect at this time. Now I'll turn today's meeting over to Mr. Ed Kiker, Senior Vice President and CFO. Thank you, sir, you may begin.

Ed Kiker - *Rayonier Inc. - SVP & CFO*

Thank you and good morning. Welcome to Rayonier's investor teleconference. The press releases we issued this morning and supplemental materials are available on our website at Rayonier.com.

I would like to remind you that in these presentations, we include forward-looking statements made pursuant to the Safe Harbor provisions of federal securities laws. Our earnings release, as well as our amended Form 10-K and our Form 10-Q filed with the SEC, list some of these factors which may cause actual results to differ materially from the forward-looking statements we may make. They are also referenced on page 1 of our presentation materials.

With that, I'll hand the conference call over to Dave Nunes, President and CEO.

Dave Nunes - *Rayonier Inc. - President & CEO*

Thanks, Ed. And good morning, everyone. Ed will walk through our results for the quarter as well as our segment results shortly. And also on the call today are Doug Long, our newly appointed Vice President of US Operations and Chris Corr our Senior Vice President of Real Estate.

The key focus on the call this morning will be to discuss the results of the internal review that we initiated this quarter, our first full quarter since the spinoff of the Performance Fibers business, and to provide detail on the immediate actions we've taken in response to this review. From there I'd like to outline our initiatives to realign our strategies and operations to build a sustainable and profitable path forward.

Let me begin with some background. Following the spinoff of Rayonier Advanced Materials on June 27 of this year, our management team initiated a review of Rayonier's operations and business strategies in the context of developing a long-range plan to present to our Board of Directors. During that process, we quickly identified issues related to our historical timber harvest levels in the Pacific Northwest. I informed the Board of these issues and at their direction we commenced an internal review of these matters with the assistance of newly retained independent legal counsel, financial advisors and forensic accountants.

In the course of this internal review, the Company also discovered issues related to our estimate of merchantable timber inventory. Specifically, in the Company's Form 10-K for 2013 Rayonier had included in its merchantable timber inventory timber in specially designated parcels located in restricted, environmentally sensitive, or economically inaccessible areas, which was incorrect, inconsistent with our historical definition of merchantable timber inventory, and a significant change from prior years. As a result of these findings, we determined that there was a material weakness in Rayonier's internal controls related to merchantable timber inventory as of December 31, 2013.

As outlined in today's announcement, we have, accordingly, revised our merchantable timber inventory estimate as of December 31, 2013 which in aggregate is approximately 10% lower from the volumes we previously disclosed. This equates to a difference of approximately 8.4 million tons in aggregate.

On a regional basis, this represents a difference of approximately 8% in our Atlantic region, 14% in our Gulf region, and 19% in our Northern US timberlands located in the Pacific Northwest. There was no change to the inventory of our New Zealand timberlands.

In addition, we concluded that for roughly a decade the average rate at which Rayonier harvested timber in our Pacific Northwest timberlands exceeded the rate those timberlands could support on a long-term basis. Going forward, we intend to manage our timberlands on a sustainable yield basis. And let me explain what we mean by sustainable yield.

We now expect to harvest, on average, levels of timber that can be sustained in perpetuity based on our estimates of biological growth and the expected productivity resulting from our reforestation and silvicultural efforts. Clearly, this realigned strategy will impact harvest levels in our Pacific Northwest timberlands. We estimate the sustainable yield of our timberlands in the Pacific Northwest to be approximately 160 million board feet, as compared to our average annual harvest over the past 10 years of 228 million board feet.

Now, I want to point out that due to historical harvesting in excess of our sustainable yield, we anticipate stepping down the harvest in our Pacific Northwest Timberlands to a level below our sustainable yield for the next several years to allow for replenishment of inventory and smoothing of age classes. Specifically, we expect to step down our harvest level in the Pacific Northwest to 125 million board feet by 2017, and maintain that level for approximately 5 to 10 years thereafter.

As a result of this stepdown, we expect that our average harvest level in the Pacific Northwest over the next five years will be approximately 140 million board feet. We anticipate that we will gradually return to a sustainable yield harvest level of 160 million board feet over the course of the next full rotation.

As part of our commitment to sustainability, we also expect a modest reduction in our Southern harvest volume relative to 2014. On average, we expect to harvest approximately 5 million tons annually from our Southern timberlands over the next five years.

Aligning our harvest levels with a more appropriate sustainable yield is an important and necessary step. At the same time, it will have an obvious impact on our cash flow generation, as will our expectation of reduced reliance on sales of non-strategic timberland, which I'll discuss in a moment. As such, our Board has reduced the fourth-quarter cash dividend to $0.25 per share, a 17% reduction from the third-quarter dividend of $0.30 per share.

Lastly, with regard to the internal review, as a result of the incorrect inclusion of certain timber in our merchantable timber inventory as of year-end 2013, we concluded that we understated depletion expense in cost of goods sold for each of the first two quarters of 2014, which led to a corresponding overstatement in our income from continuing operations for the same periods. Accordingly, we are restating our financials for the first two quarters of 2014 and filing amendments to our Form 10-Q. Ed will provide additional details on this later on.

With that said, let me reflect on this internal review process. From the start, we had focused on two things. First, to conduct a thorough, comprehensive review; and, second, once the facts became clear, to take quick and decisive action. With the appropriate determinations now in place, we turn to a path forward.

Again, we're mindful that swift action is necessary and we've highlighted in our release this morning, we are moving to immediately realign our strategy. This strategy is best summarized as follows.

Today's Rayonier is focused on sustainably managing our timberland resources, supporting cash flow generation, effectively allocating capital, and driving long-term shareholder value. Let me briefly review our five key strategic imperatives that will underpin how we operate and approach the business going forward.

First, Rayonier's harvesting strategy is designed to produce a long-term, sustainable yield. What this means is that we will actively manage our timberlands to maximize net present value over the long term by achieving the right balance among biological timber growth, generation of cash flow from harvesting and responsible environmental stewardship. While we may periodically adjust harvest levels to capitalize on then current economic conditions in our markets, we're committed to maintaining the sustainable yield strategy going forward.

Second, we'll take a prudent and disciplined approach to timberland acquisition opportunities, with a focus on improving the average productivity of our timberland holdings and supporting cash flow generation from harvesting activities. Rayonier continues to upgrade its portfolio by selling non-strategic timberland and acquiring higher-quality land in stronger markets.

For example, through the end of the third quarter of this year, Rayonier acquired 47,000 acres, with an average site index of 74 and an average inventory stocking of 45 tons per acre. During the same period Rayonier sold 33,000 acres of non-strategic timberland, with an average site index of 68 and average inventory stocking of 29 tons per acre.

We expect to generally focus our acquisition efforts on the most commercially desirable timber-producing regions in the US South and US Pacific Northwest, particularly on timberlands that complement our existing holdings. Despite the operational challenges outlined earlier, Rayonier maintains a strong balance sheet and we believe that we will have continued access to capital on favorable terms which will in turn enable us to fund future timberland growth opportunities.

Third, I'd like to talk about our HBU strategy. Rayonier continuously assesses potential alternative uses of timberlands, as some of our properties may be more valuable for development, conservation, recreation, or other purposes. We intend to capitalize on the value of our portfolio by opportunistically monetizing HBU properties.

While the majority of our HBU sales involve rural and recreational land, Rayonier also selectively pursues various land use entitlements on certain properties for residential and industrial development in order to enhance the long-term value potential of those properties. We generally expect that sales of rural and development HBU property will comprise approximately 1% of our Southern timberland holdings on an annual basis.

The fourth point I'd like to highlight is that, while we expect to take advantage of opportunistic sales of HBU properties, we also plan to de-emphasize sales of non-HBU timberlands going forward. While we may periodically generate income and cash flow from the sale of non-strategic timberland as part of our goal of optimizing our portfolio by disposing of less desirable properties, we generally expect to reduce our reliance on planned sales of non-HBU timberlands to augment cash flow generation.

Over the past five years, sales of such non-strategic timberlands totaled approximately 285,000 acres and $290 million. Going forward, we generally expect that our sales of non-strategic timberlands will be significantly lower as we sharpen our focus on durable cash flow generation from our core operations.

And, finally, we are committed to establishing Rayonier as an industry leader in transparent disclosure, particularly relating to our timberland holdings and harvest schedules. For those of you that know me, you know that I'm committed to transparent disclosure and investor communications, and you'll see that process beginning here at Rayonier with the new disclosure in our third quarter Q. I believe that our commitment to transparency and responsible stewardship of our assets and capital will allow us to maintain the productivity of our timberlands, more effectively attract and deploy capital, and enhance our reputation as a preferred timber supplier.

I'd also like to briefly mention the management transition that was announced separately today. Doug Long, a 19 year Rayonier veteran, has been appointed Vice President of US Operations, reporting directly to me. Doug has proven to be a dedicated leader and true steward of our Company's core values.

In his new role, Doug will oversee Rayonier's Forest Resources operations across all regions of the US. Doug succeeds Lynn Wilson who has decided to step down from her role as Executive Vice President of Forest Resources.

In her four years at Rayonier, Lynn has been a committed team member and a valued colleague. We appreciate her agreeing to provide transition assistance for the next two months and we wish her all the best in the future.

With that, I will turn it over to Ed who will discuss the financial results. Ed.

Ed Kiker - *Rayonier Inc. - SVP & CFO*

Thanks, Dave. Let's start with overall financial results and highlights, as shown on page 4 of the supplemental materials posted on our website.

We had a solid third quarter with sales of $150 million, operating income of $32 million, and net income attributable to Rayonier of $33 million. The quarter included one special item, an unfavorable $3 million cumulative out-of-period adjustment to correct for immaterial errors in depletion expense reported in prior years.

Also, in our year-to-date comparisons, we have excluded a $16 million gain recorded in the second quarter 2013 from acquisition of an additional 39% interest in our New Zealand joint venture. We have also excluded the results of our discontinued performance fibers and woods products businesses to arrive at pro forma operating income and pro forma net income, which will be used throughout this call for the comparisons with prior periods.

Also on page 4 of the third-quarter supplemental materials, we provide an outline of capital resources and liquidity. Our year-to-date cash flow has been solid with pro forma adjusted EBITDA of $183 million, and cash available for distribution of $120 million.

We ended the quarter with $736 million of debt and $183 million in cash, so on a net debt basis, $553 million. We continue to feel very comfortable with our current balance sheet and liquidity.

Let's now briefly run through the variance analyses. Page 5 of our third-quarter financial supplement provides a sequential variance analysis of pro forma operating income.

In Forest Resources, third-quarter operating income was comparable to the second quarter as favorable non-timber income and mix in the US, and lower New Zealand costs were offset by a decline in New Zealand prices due to weaker export markets. Despite a strong third quarter, Real Estate operating income was $11 million below the prior quarter, which included a large non-strategic timberland sale. Corporate and other expenses were $7 million favorable to the prior quarter, primarily due to the spinoff of Performance Fibers.

Page 6 of the financial supplement provides variances to the prior-year periods. This quarter higher prices in the US South were offset by lower volumes in the US and by price declines in New Zealand.

Year to date, Forest Resources' operating income was $10 million above 2013, reflecting higher prices in the South and Pacific Northwest, partially offset by higher costs. However, we are reducing Northwest harvest volumes in the fourth quarter so Forest Resources fourth-quarter and full-year results will be below our previous guidance. Real Estate was favorable to the prior year quarter due to higher rural sales volume, while corporate expenses were below last year, primarily due to the spinoff of Performance Fibers.

Now I'll provide more detail on this quarter's segment results. In the Atlantic and Gulf regions, average pine stumpage prices fell slightly compared to second-quarter levels due to a higher percentage of thinning harvest, but were 6% higher than third quarter last year due to a favorable mix of grade timber, coupled with stronger pulpwood and chip-and-saw prices. We anticipate that 2014 pine harvest volume will be 3% higher than 2013 as we integrate recent acquisitions.

Now let's move to the Northern region which comprises our Washington state operations. Delivered log prices were favorable compared to the second quarter as we were able to sell more volume for export at favorable prices. This quarter, 29% of our delivered saw logs were sold into the export market. Domestic prices remain strong, as domestic prices generally lag export pricing. As a result, prices overall exceeded third quarter last year by 4%.

We expect fourth-quarter prices to be below prior quarters as reduced export demand resulting from elevated log inventory levels in China ports weighs on domestic prices. For the full year, we expect delivered log prices will increase approximately 4% compared with 2013, primarily reflecting the particularly strong first half 2014 prices that we were able to achieve.

Now let's review results for our joint venture in New Zealand. Third-quarter export prices declined 11% from the prior quarter due to higher log inventories in China. Domestic log prices declined 6% from the prior quarter in response to the declining export market, as well. We expect fourth-quarter export pricing to approximate third-quarter pricing, but we anticipate further declines in domestic prices.

Now I'll provide a brief update on timberland acquisitions. So far this year we have evaluated 1 million acres and have either closed or have under contract nearly 74,000 acres for a total of $152 million. This quarter we closed on an 11,000-acre balanced age class property in East Texas near our current ownership, which also has good land sales opportunities.

Now turning to Real Estate, third-quarter earnings were significantly higher than the same quarter last year, mainly due to an increase in rural acres sold, including the sale of a 5,200-acre tract in Marion County, Florida. While this quarter's earnings were lower than the previous quarter, which included the sale of a 19,500-acre non-strategic timberland tract in Gilchrist County, Florida, rural sales volume was significantly higher than last quarter, and we anticipate continued solid sales of rural HBU. Real Estate operating income for the full year is now expected to be approximately $47 million to $50 million, as closings of two larger sales will likely slip to 2015.

Rural HBU pricing was slightly higher this quarter compared with the prior-year quarter, reflecting continuing demand for quality recreational property. Development sales prices approximated the prior year, but were well below the prior quarter, which included a six-acre sale in Nassau County, Florida for $174,000 per acre for a highway expansion project.

Dave noted earlier that we are restating our first and second quarter Form 10-Qs to correct understatements in depletion expense. These errors resulted from using incorrect 2014 timber depletion rates that were determined in late 2013. Depletion expense was understated, and income from continuing operations was correspondingly overstated by approximately $2 million in each of the first and second quarters of 2014.

As we performed an in-depth review of timber volumes used in the initial 2014 depletion rate calculations we also identified immaterial errors in prior years resulting from the inappropriate inclusion in the rate calculations of timber volumes located in certain environmentally restricted areas, and we found other immaterial errors. Our estimate of the cumulative error related to prior years was $2.6 million, which was reported as an out-of-period adjustment this quarter.

Now turning to our guidance. On page 8 of our third-quarter financial supplement we provide estimated full-year 2014 guidance for key financial measures. Also on page 8 we are giving broad guidance for 2015 now, rather than in January which is our typical practice.

With the decreased harvest volumes and our new strategy, as Dave discussed, we thought it was important to indicate at least directionally the impact of these changes on 2015. We would like to emphasize that we have not yet completed our 2015 budget reviews and that our 2015 guidance is preliminary.

We plan to refine our forecast and provide an update in January. Looking beyond 2015, we expect improving results and cash flows as housing markets continue to slowly recover.

I'll now turn the teleconference back to Dave.

Dave Nunes - *Rayonier Inc. - President & CEO*

Thank you, Ed. The changes to our strategy, management, and reporting structure that I discussed earlier are only part of a much broader effort to sharpen our focus on transparency and accountability at every level of our organization. All of us at Rayonier are rededicating ourselves to embodying the core values that have helped Rayonier build the Company to what it is today.

Rayonier is fortunate to have the most talented and dedicated employees in the industry who embody and live by these core values every day. I'm confident that, by the actions we've taken and the realignment of our strategy we announced today, that we have a bright future ahead of us.

With that, we're happy to take questions. Operator.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from Mike Roxland of Bank of America-Merrill Lynch.

Mike Roxland - *BofA Merrill Lynch - Analyst*

Thanks for taking my questions. Dave, just wanted to get a sense from you, was there anything else that prompted this review, or was it just simply the spin off of RYAM and you wanting to just figure out what the operations looked like on a more detailed level post spin?

Dave Nunes - *Rayonier Inc. - President & CEO*

It really had to do with the latter, of getting, as a new CEO, getting out on the ground and seeing the operations. It was not related to the spin but more what you would expect as a new CEO.

Mike Roxland - *BofA Merrill Lynch - Analyst*

Got you. Why weren't the Company's auditors able to pick this up sooner?

Dave Nunes - *Rayonier Inc. - President & CEO*

Certainly the Board was not aware of this. And once we alerted the Board to that, I'm pleased with the actions that they took and collectively working with the Board to launch this internal review and get after this as quickly as possible.

Mike Roxland - *BofA Merrill Lynch - Analyst*

Got it. Was there any reason why the auditors weren't able to pick it up? Was it something that wasn't disclosed to them or how did -- ?

Dave Nunes - *Rayonier Inc. - President & CEO*

Recognize that most of the things that are included in our results were things that were not -- they're part of the 2014 audit that had not yet occurred. The two were statements that Ed referred to, were part of our 2014 results and the adjustment to our 10-K was the disclosure of our inventory information.

Mike Roxland - *BofA Merrill Lynch - Analyst*

Got you. Last question and I'll turn it over. Is the dividend cut that you've announced this morning more a function of lower timber harvest and less dependency on land sales? And what gives you comfort that this is the right level for the dividend, particularly as you're curtailing harvest?

Dave Nunes - *Rayonier Inc. - President & CEO*

I think, recognize that as we have emerged as a smaller, more pure play REIT, we've got to do the right things that fit our assets. And so, as we adjusted the harvest and looked carefully at what was best from a long-term value standpoint on our broader timberland assets, we decided it does not make sense for us to continue selling non-strategic timberlands simply to generate cash flow. And so as we had adjusted both the harvest levels and the sale of non-core timberlands, which we really view as an issue of quality of earnings, we feel that we've got the right posture going forward. And then the dividend simply is a byproduct of that.

Mike Roxland - *BofA Merrill Lynch - Analyst*

Thank you.

Operator

Thank you. Our next question is Paul Quinn of RBC.

Paul Quinn - *RBC Capital Markets - Analyst*

Yes, thanks very much. Just want to understand the overstatement of the merchantable timber inventories. Is that a hard and fast calculation or is that more of a gray zone, especially around economically inaccessible areas?

Dave Nunes - *Rayonier Inc. - President & CEO*

Recognize that timber inventory by itself involves estimates every year. You're doing statistical sampling. And in this case there were stands that had been previously excluded for the various reasons described in our release, that as of the end of 2013 were included in those volumes. And so, as we went back and took a detailed look, we went literally item by item, and it was more a case of excluding things that had been added into as opposed to changing the methods that we were assessing particular stands of timber, if that makes sense.

Paul Quinn - *RBC Capital Markets - Analyst*

I get that. So, it sounds like the error occurred really at the end of 2013 with the database at that point?

Dave Nunes - *Rayonier Inc. - President & CEO*

Correct.

Paul Quinn - *RBC Capital Markets - Analyst*

Okay. And just a question on overall US timberland markets. You guys are active in the market, buying and selling. How do you characterize that market right now in terms of potential for M&A going forward?

Dave Nunes - *Rayonier Inc. - President & CEO*

We have certainly seen a pickup in the activity of timber transactions this year and I think that's driven by a number of factors. One, from the TIMO side where you have a large supply of land, you are starting to see turnover in fund life as funds near the end of their term length. You're starting to see managers putting those properties up for sale. And that's something that we anticipate going forward will continue to represent a large component of the supply of timber.

We've seen that in both the South as well as in the Pacific Northwest. And I think our activity level is indicative of that. The fact that we have been able to either purchase or have under contract, as Ed had mentioned. $152 million of timber through the year is a significant increase where it was last year, and some of that certainly is a function of the greater activity level of transactions.

Paul Quinn - *RBC Capital Markets - Analyst*

Again, last question I had was just on export markets out of the North and New Zealand into China. You stated that log inventories, import inventories were still slightly high. What do you expect for 2015 out of that market in terms of demand?

Dave Nunes - *Rayonier Inc. - President & CEO*

I think if you look at it in a short-term and long-term sense, I think that the inventories in the Chinese ports are quite high right now. And we do expect that that will result in impact short term. It's our understanding that that is more a function of Northwest logs as opposed to radiata pine coming out of New Zealand.

Nevertheless, that will have a dampening effect on Northwest log exports while those inventories draw down. And you should expect to see a lower application rate to the export markets in the Pacific Northwest as a result of that.

Having said that, in a longer-term sense I think the fundamentals in China are still strong in the context that China needs to be a large net importer of wood. That has not changed. So, even if China's growth rate declines, which it looks like it has some, they are still a very large consumer of wood from other countries.

Paul Quinn - *RBC Capital Markets - Analyst*

Great. That's all I had. Thanks very much.

Operator

Thank you. Next question is Collin Mings of Raymond James.

Collin Mings - *Raymond James & Associates, Inc. - Analyst*

Good morning, Dave, Ed. A couple of questions. First off, can you talk about the decision or maybe even the error that led to overharvesting so long in the West? You're looking at about a 40% adjustment related to what you've been harvesting over the last decade. Can you maybe talk about the decision to trim that back, particularly given the fact that that continues to be a relatively stronger market compared to the US South.

Dave Nunes - *Rayonier Inc. - President & CEO*

Collin, I'm not going to speculate on why those decisions were made. We're really looking at this going forward, as I said earlier, as a smaller, pure play REIT. We are taking a fresh look at how we want to manage those assets. We, quite honestly, didn't spend a lot of time trying to figure out why they were managed the way they were managed.

Collin Mings - *Raymond James & Associates, Inc. - Analyst*

Okay. And then maybe just can you talk about what led to just the larger inventory adjustment in the Northern region compared to the Atlantic and Gulf region?

Dave Nunes - *Rayonier Inc. - President & CEO*

It's my understanding, Collin, that has to do with the various categories that were included in the inventory that had not previously been included, and recognize that Washington state has a stronger regulatory overlay than in the South. And, so, as a percentage of the acre base, you have a larger percentage of the acre base in the Northwest that's tied up in riparian management zones. That volume was included and that's why as a percentage sense you're seeing a much larger impact there than in other parts of the country.

Collin Mings - *Raymond James & Associates, Inc. - Analyst*

Okay. And to that point, Dave, just to further clarify, I think it came out in one of the questions already, but you're really not adjusting your definition of merchantable inventory at all. It is really just something got captured at the end of last year that shouldn't have in context of the definition that you've had the last couple years, and you're just correcting for that error. It's not really a redefinition or reclassification, it's just kind of correcting an error, correct? Is that the right way to think about it?

Dave Nunes - *Rayonier Inc. - President & CEO*

I would think about it as an area-based thing. At the end of 2013, there were areas that were included that should not have been included. It does not have to do with the actual process of making the estimates on a particular acre. It has to do with should that acre have been included as part of merchantable timber inventory or not.

Collin Mings - *Raymond James & Associates, Inc. - Analyst*

Okay. Thanks. That's helpful. And then just two quick follow-ups here. Just stepping back to 2Q as it relates to an acquisition that you guys talked about last quarter, it was about 15,000 acres, it looks like you guys may have paid over $3,000 an acre for some of that Timberland in Georgia. Can you just remind us of some of the characteristics of that particular timberland, and just, again, talk about the pricing environment in general that warrants that type of pricing?

Dave Nunes - *Rayonier Inc. - President & CEO*

Sure. I'll touch on this and then I'll put Doug Long on the hot seat here on day one of the job. This was a property that the Company was very excited about. And a lot of that had to do with what I described earlier, we look at all the acquisitions as we're assessing them in terms of their qualitative attributes. This was a property that had very heavy stocking, very high site and it literally was significantly better in all respects to our base portfolio.

It also had a very large contiguous land base so it was going to result in some nice operating cost dynamics. And so, as a result, you see that translated into a higher price. And recognize also that it's in an area where we've had a lot of HBU experience.

And, so, one of the things that we look at whenever we're assessing timber properties, as well, is the proximity of that property relative to our other operations. And we tend to think about that in an execution risk context. If we're familiar with the local log markets and the real estate markets, we take that into account from an execution risk standpoint. And so this was a property that was interspersed with a lot of our other properties, so we felt very comfortable in that geography. Doug, what additional would you add to that?

Doug Long - *Rayonier Inc. - VP of US Operations*

Thanks, Dave. Dave's done a very good job explaining it. For context I would say this is a property that Rayonier's had a look at for a long time. It's among our current land base, as he mentioned. Really above quality timber, what we've seen from it. The prior managers had done a good job with it.

We had stocking out there that we thought we could capitalize on and markets that were very strong for us. Historically this is an area that we have great confidence in and ability to execute on. And also, as Dave mentioned, there's good HBU in the area, and there's some entitlements that have been in place for that property also. So, we saw lots of advantages.

Collin Mings - *Raymond James & Associates, Inc. - Analyst*

Okay, great. Thanks for that additional color. And then just one last one, and I may have missed it. As you think about instituting that 2015 forecast -- again recognizing you're still going through the planning process there -- what type of saw log price appreciation in the US South is embedded in that?

Dave Nunes - *Rayonier Inc. - President & CEO*

Thanks, Collin. That's a good question. One of the things that we are putting forth in the context of our planning effort is a more conservative approach on the recovery of the housing market where currently our forecast includes hitting the 1.5 million housing starts by 2018, which is a fairly slow and steady ramp-up. So, we have fairly modest price recovery built in pursuant to that underlying housing forecast.

Collin Mings - *Raymond James & Associates, Inc. - Analyst*

Okay. So, think about maybe low single digits next year? Is that a fair way to think about it?

Dave Nunes - *Rayonier Inc. - President & CEO*

Yes, I think that's probably a fair way to think about it.

Collin Mings - *Raymond James & Associates, Inc. - Analyst*

Okay. Thanks, guys. I'll turn it over.

Operator

Thank you. Next question is Mark Weintraub of Buckingham Research.

Mark Weintraub - *Buckingham Research Group - Analyst*

Thank you. I was hoping to get a little bit more color on how you think through the dividend, not just right now but over time. Is it a percentage of CAD from the timber operations exclusively? How do you think about the cash that comes from HBU sales, as well?

Dave Nunes - *Rayonier Inc. - President & CEO*

Thanks, good question. The way that we are approaching the setting of the dividend is -- I'll give you a couple of dynamics. One, we like to look at the recurring timber harvest cash flows and then the sale of what we call our base HBU rural land sales. And that we would like to think more of our development land sales which are going to be lumpier in nature as more capital that can be used for other purposes. But we definitely include those core HBU land sales as part of the effort.

And then the other thing to recognize, it's not quite as simple as simply looking at cash available for distribution in the context of the dividend, because as a REIT we have required REIT distributions, and so you've always got to balance that REIT taxable income requirement with your CAD generation.

Mark Weintraub - *Buckingham Research Group - Analyst*

And can you give us a sense as to, over time, what percentage of CAD using the timber and the core rural land sales you think is appropriate to be dividend out as opposed to reinvested and allow you to meet the requirements at the same time?

Dave Nunes - *Rayonier Inc. - President & CEO*

Again, we look at it as the interplay between those two as opposed to a percentage of the CAD.

Mark Weintraub - *Buckingham Research Group - Analyst*

Okay. And I realize this is probably a tough one, but in terms of that potential development capital or the capital that comes from development sales, are you at this stage able to frame how significant that could be over time?

Dave Nunes - *Rayonier Inc. - President & CEO*

I think the important thing to recognize on the development projects is these are very long-term projects in nature. Chris Corr and his team have done a good job of prioritizing which of those projects we feel have the greatest near-term potential. But recognize that near term is still quite a ways out in terms of all the things that you have to do from an entitlement standpoint.

One of the things that you'll see more in our discussions and our materials going forward is we talk about the need for developing catalysts to help some of those projects move along. So, that's something that Chris and his team are focusing on.

Mark Weintraub - *Buckingham Research Group - Analyst*

Thanks very much.

Operator

Thank you. Next question is Steve Chercover of D.A. Davidson.

Steve Chercover - *D.A. Davidson & Co. - Analyst*

Thanks. Good morning, everyone. We're going to be talking about --. Having the spin of Performance Fibers and the management changes, do you think that your overharvesting would have gone on until there was a crisis?

Dave Nunes - *Rayonier Inc. - President & CEO*

I think, Steve, the thing to keep in mind is that you have a physical limitation of merchantable timber. And so this is something that we believe would have indeed come to light before too long.

Steve Chercover - *D.A. Davidson & Co. - Analyst*

And since the previous restatement was fairly minimal -- I think Ed said $2.6 million -- this was really something that started in 2014, although there were evidently issues going back further, and consequently it shouldn't really impair our view of the value of all of your land?

Dave Nunes - *Rayonier Inc. - President & CEO*

Steve, think about it in two different ways. You have a rate of harvest going forward, which is one issue. And the whole restatement of the inventory and resultant change in depletion, that's really a very separate issue. That's more of a disclosure of the merch inventory and the calculation of the depletion that doesn't really bear a lot of weight onto the underlying asset value. The harvest level does, though.

Steve Chercover - *D.A. Davidson & Co. - Analyst*

And to be clear, if you were counting as inventory trees that couldn't have been harvested, given their sensitive location and overharvesting on core timberlands, did you hit any of that environmentally sensitive land? And might there be any issues from a legal perspective if you encroached on that sensitive land?

Dave Nunes - *Rayonier Inc. - President & CEO*

That's an important distinction there. It was not that harvesting was taking place in any of those environmentally sensitive areas. It was that we were simply borrowing from some future years harvest in the current periods.

Steve Chercover - *D.A. Davidson & Co. - Analyst*

I think that is an important distinction, and that's a good answer. Dave, do you think that this might be a dirty little secret that's common in the industry?

Dave Nunes - *Rayonier Inc. - President & CEO*

Steve, I'm not going to speculate on that. That's for others to do.

Steve Chercover - *D.A. Davidson & Co. - Analyst*

Okay. And final question -- how would you characterize your silvicultural practices? Are they still best in class?

Dave Nunes - *Rayonier Inc. - President & CEO*

I've been very -- and, granted, I'm still learning my way around here -- but I've been very impressed by what I've seen thus far. One of the things that I'm quite pleased to see is a very deeply ingrained set of thinking, down to the forester level, in terms of the application of silvicultural practices and the understanding of the financial impacts of various practices. So, this is not a company that's run where you've got rote silvicultural practices being dictated. It's very much a dynamic model that relies on the foresters' expertise and understanding of the local conditions, and then applying a fairly broad suite of tools against it.

So, I've been very impressed on that. It's something that I, coming into the Company, I wanted to make sure that we were putting all those investments into place, and I've been very pleased with what I've seen thus far. Doug, what would you add to the silvicultural application question?

Doug Long - *Rayonier Inc. - VP of US Operations*

I would just it's something that myself and the rest of the foresters around here take great pride in and have worked hard towards accomplishing. And what Dave's mentioned I think is right on it. It's good to get that validation from someone stepping in from the outside and coming in and looking at it. So, I think we do, just as Dave said, we really look to maximize that net present value off each and every acre, and apply what we've learned and continually put in new research to learn new things, and just keep focusing on the future and growing.

Steve Chercover - *D.A. Davidson & Co. - Analyst*

Okay. Like you said, Dave, it's early in the morning but I think this news explains why you were late in the reporting cycle. We're just glad to have this addressed now. Thank you.

Operator

Thank you. Next question is Chip Dillon of Vertical Research Partners.

Chip Dillon - *Vertical Research Partners - Analyst*

Good morning. When I look at the Gulf Coast decline in the merchantable timber, I'm just wondering how much of that might be from those 2011 acquisitions. I think one of them was called the Oklahoma -- it had another name to it -- Joshua properties that actually were not only in Oklahoma but Louisiana, Mississippi and Alabama. I seem to recall that there was an indication that the EBITDA contribution would be around $40 million from just that acquisition, which certainly on a per acre basis was way above what the Company was generating and has generated up until now. And I just didn't know if that had been recalibrated, as well.

Dave Nunes - *Rayonier Inc. - President & CEO*

No. The inventory really -- recognize that it was simply more a function of including acres and the volume in those acres that had not been included before. So, in the South it really had to do more with wetland areas that had been included before, and then to some degree some lands tied up with the Red Hill Salamander that were not included that became part of that 2013 estimate. Again, it's like when we talked about with the answers with Steve's questions -- this isn't affecting that underlying character of the cash flow production, it's more the characterization of the inventory.

Chip Dillon - *Vertical Research Partners - Analyst*

Okay. That would be a way of saying that everything they bought in those acquisitions was merchantable and not subject to being in the restricted areas.

Dave Nunes - *Rayonier Inc. - President & CEO*

I think whenever you buy an acquisition you're going to have properties that are in restricted areas. That's pretty normal fare and it varies by region.

Chip Dillon - *Vertical Research Partners - Analyst*

Okay. And then looking at the Northern region, the 20% factor of the change in what's merchantable, can you give us a little color in terms of how you would break that out into either being just restricted -- which I'm not quite sure what that means, if that's a legal -- the government won't let you get in there, versus environmentally sensitive and versus economically inaccessible? Is it roughly one-third each or was it tilted toward one of those three -- or two of those three designations?

Dave Nunes - *Rayonier Inc. - President & CEO*

Recognize that in the Northwest you have -- Washington state has a regulatory overlay that's different than other parts of the country. And a big part of that has to do with a process of protecting streams for fish. And, so, in Washington state there is a three-pronged protection of riparian management zones that include a core zone, where you're not allowed to take any harvesting at all, and then an inner zone and an outer zone. And those zones are variable by the stream width.

And properties, such as Rayonier's that are predominantly on the west side of the Olympic mountain range, you have a lot of rivers going through there, and as a result Rayonier has a fairly high proportion of what we call nonproductive lands that are lands located in those riparian management zones. And so that's going to be -- the bulk of the change will be in that area.

The economically inaccessible reference are for things that might be on isolated pockets of timber that were left over or hard to get to, maybe on a mountain top kind of thing where you might require helicopter logging to get to it, where it doesn't have economic viability due to the harvesting costs needed to get to it, that type of thing. But I think the simple way to think about it is those very large riparian management zones.

Chip Dillon - *Vertical Research Partners - Analyst*

Okay. And then the last thing, could you talk a little bit about what your thoughts are. We remember the name Terrapointe from back in the day, and the opportunities with the acres that are near Interstate 95 in both Northern Florida and Southern Georgia. David, I didn't know if there was any thought -- because you gave this 1% of HBU land should be the level -- but I would think given the nature of residential real estate, it could be more lumpy. Certainly as we think about the dollars if in fact you do have opportunities as we had learned about eight years ago, before the crisis, that there were rezoning possibilities and ways that you could make a lot of money per acre down in those areas.

Dave Nunes - *Rayonier Inc. - President & CEO*

Let me break that up into a couple pieces, and then I'll ask Chris Corr to chime in, as well. When we refer to the 1% of our Southern ownership, we're really referring there more to the operational land sales of basic HBU rural properties. And when we talk more about a subset of that coastal Florida, Georgia area, there we're talking about projects that have deeper, longer-term, higher-value real estate potential but they're going to take some work.

And, so, what Chris' team has done is to go through that land base and really prioritize in a few areas where we think we have the most potential, and then we're working on projects to unlock those values. But it's a fairly long-term entitlement effort to do so. So, very different from that 1% which was meant more as that operational piece. Chris, what would you add to that?

Chris Corr - *Rayonier Inc. - SVP of Real Estate*

Chip, it's Chris. Dave said it -- the operational land sales is one area that works across the portfolio. We are typically marketing rural recreation and rural residential land that has traditionally had a fairly stable base to it, so one thing that we manage in one way. And then there's this subset of some key areas, mostly in Florida and Georgia, that we think over time have some potential for development. And each one of those have their own story, their own time frame, our own point of view about how much and how fast. And we'll continue to be disciplined about optimizing those opportunities.

Chip Dillon - *Vertical Research Partners - Analyst*

And it sounds to me, just to sum up, that those, at least as you plan your strategy, that those are icing on the cake type opportunities in the future. And that perhaps as you realize those two, five, eight years, whenever, down in the future, down the line, that you'll at that point decide whether, do we pay a special dividend, do we buy back stock, do we acquire more timberland, that that's the way we should think about those opportunities.

Dave Nunes - *Rayonier Inc. - President & CEO*

Yes, that's well said. I think I view it very similarly.

Chip Dillon - *Vertical Research Partners - Analyst*

Thank you.

Operator

Thank you. Our last question is from Collin Mings of Raymond James.

Collin Mings - *Raymond James & Associates, Inc. - Analyst*

Good morning, again. Thanks for the follow-up. Just a couple quick questions. I think in the prepared remarks you highlighted the site index of the timberland you guys were acquiring in the US South. Can you maybe just share what that is for the portfolio overall? I think you said what you sold and what you bought, but how does that compare to the portfolio overall?

Dave Nunes - *Rayonier Inc. - President & CEO*

Collin, I don't have that in front of me but that's a great lead in to one of the things I talked about earlier, that we intend to not have these questions in the future because you'll have all that information in front of you. So, stay tuned for a deeper dive when we get to the 10-K, and we intend to supply that type of information for you.

Collin Mings - *Raymond James & Associates, Inc. - Analyst*

Okay. And then, Dave, just as it relates to -- a lot of conversation about that definition of merchantable timber. How has the Rayonier definition compared to other companies as you conducted this internal review, that definition, is it consistent across other timber REITs and some of the other timber companies out there? Or do you think the Rayonier definition or each company in the peer group might have a slightly different definition?

Dave Nunes - *Rayonier Inc. - President & CEO*

I'll leave that to you. I'll just speak to our own definition. In the South we use 15 years for everything but Oklahoma which is 17 years. And then in the Northwest we use 35 years.

Collin Mings - *Raymond James & Associates, Inc. - Analyst*

Okay. That's very helpful. And then the last question, Dave, just as you've completed this internal review can you talk a little bit more about how you think about New Zealand? And I know there's been conversation on prior Rayonier calls about continuing to look at opportunities in New Zealand or maybe Australia, but applying a little bit higher discount rates to acquisitions in those markets. Do you continue to see an opportunity internationally or might it make sense to redeploy some of that capital in the US?

Dave Nunes - *Rayonier Inc. - President & CEO*

I think that we're still in the process of assessing that. I think generally we're excited about the exposure that we have in New Zealand from just a differentiation standpoint. We're the third largest land owner there. And it gives us great access to the China market which we think is going to be a strong long-term market, and it gives us a different access point to that market than Pacific Northwest timberlands.

So, we're generally pleased to be there. We're very much in the throes of trying to address internally the question that you laid out in terms of that capital allocation as it relates to acquisitions.

Collin Mings - *Raymond James & Associates, Inc. - Analyst*

Okay. And I apologize, I have one last one. Maybe just broadly on the acquisition environment in the US South, can you talk about it? I know you may not want to reference specifically what Rayonier uses but just talk about maybe the range of real discount rates that you think are being utilized on most of the acquisitions out there right now.

Dave Nunes - *Rayonier Inc. - President & CEO*

I won't speculate on what various folks are using for the specific real discount rates. I would say that, as we've seen net inflows of capital into the market and we've seen the impending recovery in housing, I think you are seeing some compression of real discount rates. That's my sense in the market, both in the South and the West.

Collin Mings - *Raymond James & Associates, Inc. - Analyst*

Okay. Thanks, Dave.

Operator

Thank you. We're showing no other questions at this time.

Dave Nunes - *Rayonier Inc. - President & CEO*

Great. Then we'll wrap it up. As I noted earlier, we've taken swift and decisive measures to strengthen Rayonier's operations and realign our strategy. We're very confident in the results of our review and believe the actions we've taken position us to prudently manage our timberland resources, increase transparency of our business, and refocus our capital allocation priorities to support our commitment to delivering long-term shareholder returns.

And with that, I thank you all for joining us on the call, and especially those on the West Coast where it was a little early this morning. Thank you and good-bye.

Operator

Thank you for your participation. That does conclude today's conference. You may disconnect at this time.
