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Wells Timberland REIT, Inc.
Form 10-Q
August 12, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended June 30, 2013

OR
 Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from _____ to _____

Commission file number 000-53193

WELLS TIMBERLAND REIT, INC.

(Exact name of registrant as specified in its charter)

Maryland

20-3536671

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification Number)

6200 The Corners Parkway

Norcross, Georgia 30092

(Address of principal executive offices)

(Zip Code)

(770) 449-7800

(Registrant's telephone number, including area code)

N/A

(Former name, former address, and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files)

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act (check one).

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Number of shares outstanding of the registrant's only class of common stock, as of July 31, 2013: 31,736,523 shares

FORM 10-Q
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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements contained in this Quarterly Report on Form 10-Q of Wells Timberland REIT, Inc. and subsidiaries (“Wells Timberland REIT,” “we,” “our,” or “us”) other than historical facts may be considered forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). We intend for all such forward-looking statements to be covered by the applicable safe harbor provisions for forward-looking statements contained in those acts. Such statements include, in particular, statements about our plans, strategies, and prospects and are subject to certain risks and uncertainties, as well as known and unknown risks, which could cause actual results to differ materially from those projected or anticipated. Therefore, such statements are not intended to be a guarantee of our performance in future periods. Such forward-looking statements can generally be identified by our use of forward-looking terminology such as “may,” “will,” “expect,” “intend,” “anticipate,” “estimate,” “believe,” “continue,” or other words. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date that this report is filed with the Securities and Exchange Commission (“SEC”). We make no representations or warranties (express or implied) about the accuracy of any such forward-looking statements contained in this report, and we do not intend to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

Any such forward-looking statements are subject to unknown risks, uncertainties, and other factors and are based on a number of assumptions involving judgments with respect to, among other things, future economic, competitive, and market conditions, all of which are difficult or impossible to predict accurately. To the extent that our assumptions differ from actual results, our ability to meet such forward-looking statements, including our ability to generate positive cash flow from operations, make distributions to stockholders, and maintain the value of our real estate properties, may be significantly hindered. See Item 1A herein, as well as Item 1A in our Annual Report on Form 10-K for the year ended December 31, 2012 and in our quarterly report on Form 10-Q for the period ended March 31, 2013, for a discussion of some of the risks and uncertainties that could cause actual results to differ materially from those presented in our forward-looking statements. The risk factors described herein and in our Annual Report on Form 10-K for the year ended December 31, 2012 and in our quarterly report on Form 10-Q for the period ended March 31, 2013 are not the only ones we face but do represent those risks and uncertainties that we believe are material to us. Additional risks and uncertainties not currently known to us or that we currently deem immaterial may also harm our business.

PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The information furnished in the accompanying consolidated balance sheets and related consolidated statements of operations, comprehensive income (loss), stockholders' equity, and cash flows reflects all normal and recurring adjustments that are, in management's opinion, necessary for a fair and consistent presentation of the aforementioned financial statements.

The accompanying consolidated financial statements should be read in conjunction with the condensed notes to Wells Timberland REIT's consolidated financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations included in this quarterly report on Form 10-Q and with Wells Timberland REIT's Annual Report on Form 10-K for the year ended December 31, 2012. Wells Timberland REIT's results of operations for the three months and six months ended ended June 30, 2013 are not necessarily indicative of the operating results expected for the full year.

WELLS TIMBERLAND REIT, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	(Unaudited) June 30, 2013	December 31, 2012
Assets:		
Cash and cash equivalents	\$ 13,357,474	\$ 11,221,092
Restricted cash and cash equivalents	1,352,822	2,050,063
Accounts receivable	893,579	658,355
Prepaid expenses and other assets	1,587,781	1,098,268
Deferred financing costs, less accumulated amortization of \$174,417 and \$58,626 as of June 30, 2013 and December 31, 2012, respectively	1,196,503	1,311,770
Timber assets, at cost (Note 3):		
Timber and timberlands, net	328,824,748	333,805,295
Intangible lease assets, less accumulated amortization of \$922,191 and \$841,686 as of June 30, 2013 and December 31, 2012, respectively	34,894	115,399
Total assets	\$ 347,247,801	\$ 350,260,242
Liabilities:		
Accounts payable and accrued expenses	\$ 1,715,089	\$ 1,689,288
Due to affiliates (Note 9)	1,636,366	1,326,255
Other liabilities	4,736,037	4,801,387
Note payable and line of credit (Note 4)	132,356,123	132,356,123
Total liabilities	140,443,615	140,173,053
Commitments and Contingencies (Note 6)	—	—
Stockholders' Equity:		
Preferred stock, \$0.01 par value; 100,000,000 shares authorized:		
Series A preferred stock, \$1,000 liquidation preference; 27,585 shares issued and outstanding as of June 30, 2013 and December 31, 2012	36,612,667	36,476,063
Series B preferred stock, \$1,000 liquidation preference; 9,807 shares issued and outstanding as of June 30, 2013 and December 31, 2012	12,172,491	12,123,992
Common stock, \$0.01 par value; 900,000,000 shares authorized; 31,753,373 and 31,800,627 shares issued and outstanding as of June 30, 2013 and December 31, 2012, respectively	317,534	318,006
Additional paid-in capital	300,881,510	301,348,146
Accumulated deficit and distributions	(144,041,796) (139,491,344
Accumulated other comprehensive income (loss)	861,780	(687,674
Total stockholders' equity	206,804,186	210,087,189
Total liabilities and stockholders' equity	\$ 347,247,801	\$ 350,260,242

See accompanying notes.

WELLS TIMBERLAND REIT, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

	(Unaudited) Three Months Ended		(Unaudited) Six Months Ended	
	June 30, 2013	2012	June 30, 2013	2012
Revenues:				
Timber sales	\$7,267,334	\$7,062,469	\$13,419,096	\$14,284,696
Timberland sales	1,309,371	10,552,180	1,853,321	10,552,180
Other revenues	675,714	677,644	1,367,793	1,341,281
	9,252,419	18,292,293	16,640,210	26,178,157
Expenses:				
Contract logging and hauling costs	3,780,638	3,849,424	7,044,108	7,846,384
Depletion	2,247,904	2,494,011	4,293,257	5,474,288
Cost of timberland sales	964,869	7,567,615	1,343,152	7,567,615
Advisor fees and expense reimbursements	1,636,366	1,648,503	2,381,608	2,393,745
Forestry management fees	569,157	570,297	1,145,861	1,143,079
General and administrative expenses	804,196	572,510	1,409,132	1,127,515
Land rent expense	257,806	498,419	567,952	1,013,297
Other operating expenses	608,903	568,410	1,269,475	1,266,358
	10,869,839	17,769,189	19,454,545	27,832,281
Operating income (loss)	(1,617,420)	523,104	(2,814,335)	(1,654,124)
Other income (expense):				
Interest income	849	182	1,999	309
Interest expense	(947,352)	(975,420)	(1,737,847)	(1,961,393)
Loss on interest rate swap	—	(12,172)	(474)	(103,165)
	(946,503)	(987,410)	(1,736,322)	(2,064,249)
Net loss	(2,563,923)	(464,306)	(4,550,657)	(3,718,373)
Dividends to preferred stockholder	(92,969)	(92,970)	(185,103)	(186,011)
Net loss available to common stockholders	\$(2,656,892)	\$(557,276)	\$(4,735,760)	\$(3,904,384)
Per-share information—basic and diluted:				
Net loss available to common stockholders	\$(0.08)	\$(0.02)	\$(0.15)	\$(0.12)
Weighted-average common shares outstanding —basic and diluted	31,757,432	31,884,699	31,775,958	31,869,820

See accompanying notes.

WELLS TIMBERLAND REIT, INC. AND SUBSIDIARIES
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	(Unaudited) Three Months Ended June 30,		(Unaudited) Six Months Ended June 30,	
	2013	2012	2013	2012
Net loss	\$ (2,563,923)	\$ (464,306)	\$ (4,550,657)	\$ (3,718,373)
Other comprehensive income:				
Market value adjustment to interest rate swap	1,456,981	—	1,549,454	—
Comprehensive loss	\$ (1,106,942)	\$ (464,306)	\$ (3,001,203)	\$ (3,718,373)

See accompanying notes.

WELLS TIMBERLAND REIT, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Common Stock		Preferred Stock		Additional Paid-In Capital	Accumulated Deficit and Distributions	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
	Shares	Amount	Shares	Amount				
Balance, December 31, 2012	31,800,627	\$318,006	37,392	\$48,600,055	\$301,348,146	\$(139,491,344)	\$(687,674)	\$210,087,189
Forfeiture of restricted stock award	(2,021)	(20)	—	—	(185)	205	—	—
Redemptions of common stock	(45,233)	(452)	—	—	(281,348)	—	—	(281,800)
Dividends on preferred stock	—	—	—	185,103	(185,103)	—	—	—
Net loss	—	—	—	—	—	(4,550,657)	—	(4,550,657)
Market value adjustment to interest rate swap	—	—	—	—	—	—	1,549,454	1,549,454
Balance, June 30, 2013	31,753,373	\$317,534	37,392	\$48,785,158	\$300,881,510	\$(144,041,796)	\$861,780	\$206,804,186

	Common Stock		Preferred Stock		Additional Paid-In Capital	Accumulated Deficit and Distributions	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
	Shares	Amount	Shares	Amount				
Balance, December 31, 2011	31,465,274	\$314,653	37,748	\$48,685,499	\$271,428,671	\$(130,620,551)	\$—	\$189,808,272
Issuance of common stock	408,980	4,090	—	—	4,110,711	(61)	—	4,114,740
Redemptions of common stock	(55,067)	(551)	—	—	(525,063)	—	—	(525,614)
Dividends on preferred stock	—	—	—	186,011	(186,011)	—	—	—
Redemptions of preferred stock	—	—	(356)	(459,436)	—	—	—	(459,436)
Commissions and discounts on stock sales and related dealer-manager fees	—	—	—	—	(361,364)	—	—	(361,364)
Other offering costs	—	—	—	—	(48,752)	—	—	(48,752)

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Write-off of due to affiliates	—	—	—	—	27,315,249	—	—	27,315,249
Net loss	—	—	—	—	—	(3,718,373)	—	(3,718,373)
Balance, June 30, 2012	31,819,187	\$318,192	37,392	\$48,412,074	\$301,733,441	\$(134,338,985)	\$—	\$216,124,722

See accompanying notes.

WELLS TIMBERLAND REIT, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	(Unaudited)	
	Six Months Ended	
	June 30,	
	2013	2012
Cash Flows from Operating Activities:		
Net loss	\$(4,550,657) \$(3,718,373)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depletion	4,293,257	5,474,288
Unrealized gain on interest rate swaps	(128,934) (451,716)
Other amortization	113,773	111,176
Stock-based compensation expense	—	8,333
Noncash interest expense	124,489	259,520
Basis of timberland sold	1,213,643	6,962,273
Changes in assets and liabilities:		
Increase in accounts receivable	(235,224) (179,209)
Decrease in prepaid expenses and other assets	375,592	181,430
Increase (decrease) in accounts payable and accrued expenses	25,801	(351,629)
Increase in due to affiliates	310,111	168,307
Increase in other liabilities	867,722	369,247
Net cash provided by operating activities	2,409,573	8,833,647
Cash Flows from Investing Activities:		
Investment in timber, timberland, and related assets	(688,108) (451,498)
Funds released from escrow accounts	697,241	4,162,322
Net cash provided by investing activities	9,133	3,710,824
Cash Flows from Financing Activities:		
Financing costs paid	(524) —
Repayment of Mahrt loan	—	(3,628,453)
Issuance of common stock	—	4,062,646
Redemptions of common stock	(281,800) (525,614)
Redemptions of preferred stock	—	(356,000)
Dividends paid on preferred stock redeemed	—	(103,436)
Commissions on stock sales and related dealer-manager fees paid	—	(447,744)
Other offering costs paid	—	(83,739)
Net cash used in financing activities	(282,324) (1,082,340)
Net increase in cash and cash equivalents	2,136,382	11,462,131
Cash and cash equivalents, beginning of period	11,221,092	6,848,973
Cash and cash equivalents, end of period	\$13,357,474	\$18,311,104

See accompanying notes.

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WELLS TIMBERLAND REIT, INC. AND SUBSIDIARIES
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2013 (unaudited)

1. Organization

Wells Timberland REIT was formed on September 27, 2005 as a Maryland corporation that has elected to be taxed as a real estate investment trust (“REIT”) for federal income tax purposes. Wells Timberland REIT engages in the ownership and management of timberland located in the southeastern United States. Substantially all of Wells Timberland REIT’s business is conducted through Wells Timberland Operating Partnership, L.P. (“Wells Timberland OP”), a Delaware limited partnership formed on November 9, 2005, of which Wells Timberland REIT is the sole general partner, possesses full legal control and authority over its operations, and owns 99.99% of its common partnership units. Wells Timberland Management Organization, LLC (“Wells TIMO”), a wholly owned subsidiary of Wells Capital, Inc. (“Wells Capital”), is the sole limited partner of Wells Timberland OP. In addition, Wells Timberland OP formed Wells Timberland TRS, Inc. (“Wells Timberland TRS”), a wholly owned subsidiary organized as a Delaware corporation, on January 1, 2006 (see Note 2). Unless otherwise noted, references herein to Wells Timberland REIT shall include Wells Timberland REIT and all of its subsidiaries, including Wells Timberland OP, and the subsidiaries of Wells Timberland OP, including Wells Timberland TRS. Under an agreement (the “Advisory Agreement”), Wells TIMO performs certain key functions on behalf of Wells Timberland REIT and Wells Timberland OP, including, among others, the investment of capital proceeds and management of day-to-day operations (see Note 9).

As of June 30, 2013, Wells Timberland REIT owned approximately 245,700 acres of timberland and held long-term leasehold interests in approximately 36,300 acres of additional timberland, all of which is located on the Lower Piedmont and Upper Coastal Plains of East Central Alabama and West Central Georgia (the “Mahrt Timberland”). Wells Timberland REIT acquired the Mahrt Timberland on October 9, 2007. Wells Timberland REIT generates a substantial portion of its revenues from selling timber and the right to access land and harvest timber to third parties pursuant to supply agreements and through open-market sales, selling higher-and-better-use timberland, and leasing land-use rights to third parties.

On August 11, 2006, Wells Timberland REIT commenced its initial public offering (the “Initial Public Offering”) of up to 85.0 million shares of common stock, of which 75.0 million shares were offered in the primary offering for \$10.00 per share and 10.0 million shares were reserved for issuance through Wells Timberland REIT’s distribution reinvestment plan (“DRP”). Wells Timberland REIT stopped offering shares for sale under the Initial Public Offering on August 11, 2009. Wells Timberland REIT raised gross offering proceeds of approximately \$174.9 million from the sale of approximately 17.6 million shares under the Initial Public Offering.

On August 6, 2009, Wells Timberland REIT commenced its follow-on offering (the “Follow-On Offering”, and together with the Initial Public Offering, the “Public Offerings”) of up to 220.9 million shares of common stock, of which 200.0 million shares were offered in a primary offering for \$10.00 per share and 20.9 million shares of common stock were reserved for issuance through Wells Timberland REIT’s DRP for \$9.55 per share. Effective December 31, 2011, Wells Timberland REIT ceased offering shares for sale under the Follow-On Offering. From January 1, 2012 to February 13, 2012, Wells Timberland REIT accepted \$4.1 million of additional gross offering proceeds from the sale of approximately 0.4 million additional shares under the Follow-On Offering, which sales were agreed to by the investor on or before December 31, 2011. On March 15, 2012, Wells Timberland REIT withdrew from registration the unsold primary offering shares. Wells Timberland REIT raised gross offering proceeds of approximately \$123.8 million from the sale of approximately 12.5 million shares under the Follow-On Offering.

Wells Timberland REIT offered up to approximately 11.4 million shares of its common stock, of which approximately 10.4 million shares were offered in a primary offering to non-U.S. persons at a price per share of \$9.65, and up to approximately 1.0 million shares of common stock were reserved for issuance through an unregistered distribution reinvestment plan at a price per share equal to \$9.55 (the “2010 German Offering”). The 2010 German Offering closed on August 6, 2011 and Wells Timberland REIT raised approximately \$8.5 million from the sale of approximately 0.9 million shares in the 2010 German Offering.

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Wells Timberland REIT raised gross offering proceeds from the sale of common stock under the Public Offerings and the 2010 German Offering of approximately \$307.2 million. After deductions for payments of selling commissions and dealer-manager fees of approximately \$24.7 million, other organization and offering expenses of approximately \$1.4 million, approximately \$0.4 million in placement and structuring agent fees, and common stock redemptions of approximately \$2.6 million under the share redemption plan (“SRP”), Wells Timberland REIT had received aggregate net offering proceeds of approximately \$278.1 million, which was used to partially fund the Mahrt Timberland acquisition, service acquisition-related debt, redeem shares of its preferred stock, and fund accrued dividends on redeemed shares of preferred stock.

Wells Timberland REIT’s common stock is not listed on a national securities exchange. Wells Timberland REIT’s charter requires that in the event its common stock is not listed on a national securities exchange by August 11, 2018, Wells Timberland REIT must either (i) seek stockholder approval of an extension or amendment of this listing deadline or (ii) seek stockholder approval to begin liquidating investments and distributing the resulting proceeds to the stockholders. In the event that Wells Timberland REIT seeks stockholder approval for an extension or amendment to this listing date and does not obtain it, Wells Timberland REIT will then be required to seek stockholder approval to liquidate. In this circumstance, if Wells Timberland REIT seeks and does not obtain approval to liquidate, Wells Timberland REIT will not be required to list or liquidate and could continue to operate indefinitely as an unlisted company.

2. Summary of Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

The consolidated financial statements of Wells Timberland REIT have been prepared in accordance with the rules and regulations of the SEC, including the instructions to Form 10-Q and Article 10 of Regulation S-X and do not include all of the information and footnotes required by accounting principles generally accepted in the United States (“GAAP”) for complete financial statements. In the opinion of management, the statements for these unaudited interim periods presented include all adjustments, which are of a normal and recurring nature, necessary for a fair and consistent presentation of the results for such periods. Results for these interim periods are not necessarily indicative of results for a full year.

Wells Timberland REIT owns a controlling financial interest in Wells Timberland OP and Wells Timberland TRS and, accordingly, includes the accounts of these entities in its consolidated financial statements. The financial statements of Wells Timberland OP and Wells Timberland TRS are prepared using accounting policies consistent with those used by Wells Timberland REIT. All intercompany balances and transactions have been eliminated in consolidation.

For further information, refer to the audited financial statements and footnotes included in Wells Timberland REIT’s Annual Report on Form 10-K for the year ended December 31, 2012.

Fair Value Measurements

Wells Timberland REIT estimates the fair value of its assets and liabilities (where currently required under GAAP) consistent with the provisions of the accounting standard for fair value measurements and disclosures. Under this guidance, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. While various techniques and assumptions can be used to estimate fair value depending on the nature of the asset or liability, the accounting standard for fair value measurements and disclosures provides the following fair value technique parameters and hierarchy, depending upon availability:

Level 1 — Assets or liabilities for which the identical term is traded on an active exchange, such as publicly-traded instruments or futures contracts.

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Level 2 — Assets and liabilities valued based on observable market data for similar instruments.

Level 3 — Assets or liabilities for which significant valuation assumptions are not readily observable in the market. Such assets or liabilities are valued based on the best available data, some of which may be internally developed. Significant assumptions may include risk premiums that a market participant would require.

Fair Value of Debt Instruments

Wells Timberland REIT applied the provisions of the accounting standard for fair value measurements and disclosures in estimations of fair value of its debt instruments based on Level 2 assumptions. See Note 4 for additional information.

Interest Rate Swaps

Wells Timberland REIT has entered into interest rate swap contracts to mitigate its exposure to changing interest rates on variable rate debt instruments. Wells Timberland REIT does not enter into derivative or interest rate transactions for speculative purposes; however, certain of its derivatives may not qualify for hedge accounting treatment. The fair values of interest rate swaps are recorded as either prepaid expenses and other assets or other liabilities in the accompanying consolidated balance sheets. Changes in the fair value of the effective portion of interest rate swaps that are designated as hedges are recorded as other comprehensive income (loss), while changes in the fair value of the ineffective portion of hedges, if any, are recognized in current earnings. Changes in the fair value of interest rate swaps that do not qualify for hedge accounting treatment are recorded as gain (loss) on interest rate swap in the consolidated statements of operations. Amounts received or paid under interest rate swaps are recorded as interest expense for contracts that qualify for hedge accounting treatment and as gain (loss) on interest rate swaps for contracts that do not qualify for hedge accounting treatment.

Wells Timberland REIT applied the provisions of the accounting standard for fair value measurements and disclosures in recording its interest rate swaps at fair value. The fair values of interest rate swaps, classified under Level 2, were determined using a third-party proprietary model that is based on prevailing market data for contracts with matching durations, current and anticipated London Interbank Offered Rate ("LIBOR") information, consideration of Wells Timberland REIT's credit standing, credit risk of counterparties, and reasonable estimates about relevant future market conditions.

The following table presents information about Wells Timberland REIT's interest rate swaps measured at fair value as of June 30, 2013 and December 31, 2012:

Instrument Type	Balance Sheet Classification	Estimated Fair Value as of	
		June 30, 2013	December 31, 2012
Derivatives designated as hedging instruments:			
Interest rate swap contract	Prepaid expenses and other assets (Other liabilities)	\$861,780	\$(687,674)
Derivatives not designated as hedging instruments:			
Interest rate swap contract	Other liabilities	\$—	\$(128,934)

For additional information about Wells Timberland REIT's interest rate swaps, see Note 5.

Income Taxes

Wells Timberland REIT has elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended (the “Code”), and has operated as such beginning with its taxable year ended December 31, 2009. To qualify to be taxed as a REIT, Wells Timberland REIT must meet certain organizational and operational requirements, including a

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requirement to distribute at least 90% of its ordinary taxable income to its stockholders. As a REIT, Wells Timberland REIT generally is not subject to federal income tax on taxable income it distributes to stockholders. Wells Timberland REIT is subject to certain state and local taxes related to the operations of timberland properties in certain locations, which have been provided for in the accompanying consolidated financial statements. Wells Timberland REIT records interest and penalties related to uncertain tax positions as general and administrative expense in the accompanying consolidated statements of operations.

As of January 1, 2009, the beginning of the taxable year in which Wells Timberland REIT qualified for and elected to be taxed as a REIT, or its REIT commencement date, Wells Timberland REIT had net built-in gains on its timber assets of approximately \$18.3 million. Wells Timberland REIT has elected not to take such net built-in gains into income immediately prior to its REIT commencement date, but rather subsequently recognize gain on the disposition of any assets it holds at the REIT commencement date, if disposed of within the ten-year period beginning on the REIT commencement date. Wells Timberland REIT will be subject to tax on such net built-in gains at the highest regular corporate rate during the ten-year period beginning on the REIT commencement date on the lesser of (a) the excess of the fair market value of the asset disposed of as of the REIT commencement date over its basis in the asset as of the REIT commencement date (the built-in gain with respect to that asset as of the REIT commencement date); (b) the amount of gain Wells Timberland REIT would otherwise recognize on the disposition; or (c) the amount of net built-in gain in its assets as of the REIT commencement date not already recognized during the ten-year period. As of December 31, 2012, Wells Timberland REIT had net built-in gains of approximately \$17.6 million.

At December 31, 2012, Wells Timberland REIT had federal and state net operating loss carryforwards of approximately \$98.1 million and \$82.2 million, respectively. Such net operating loss carryforwards may be utilized, subject to certain limitations, to offset future taxable income, including net built-in gains. If not utilized, the federal net operating loss carryforwards will begin to expire in 2027, and the state net operating loss carryforwards will begin to expire in 2022.

Wells Timberland REIT has elected to treat Wells Timberland TRS as a taxable REIT subsidiary. Wells Timberland REIT may perform certain non-customary services, including real estate or non-real-estate related services, through Wells Timberland TRS. Earnings from services performed through Wells Timberland TRS are subject to federal and state income taxes irrespective of the dividends paid deduction available to REITs for federal income tax purposes. In addition, for Wells Timberland REIT to continue to qualify to be taxed as a REIT, Wells Timberland REIT's investment in Wells Timberland TRS may not exceed 25% of the value of the total assets of Wells Timberland REIT.

Deferred tax assets and liabilities represent temporary differences between the financial reporting basis and the tax basis of assets and liabilities based on the enacted rates expected to be in effect when the temporary differences reverse. Deferred tax expense or benefit is recognized in the financial statements according to the changes in deferred tax assets or liabilities between years. Valuation allowances are established to reduce deferred tax assets when it becomes more likely than not that such assets, or portions thereof, will not be realized.

No provision for federal income taxes has been made in the accompanying consolidated financial statements, other than the provision relating to Wells Timberland TRS, as Wells Timberland REIT did not generate taxable income for the periods presented.

Recent Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update 2013-02, Comprehensive Income: Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income ("ASU 2013-02"). ASU 2013-02 requires an entity to disclose information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to disclose significant

amounts reclassified out of accumulated other comprehensive income by the respective line items of net income if the amount reclassified to net income in its entirety in the same reporting period is required under GAAP. For amounts that are not required under GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under GAAP that provide additional detail about those amounts. ASU 2013-02 was effective for Wells

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Timberland REIT for the period beginning January 1, 2013. The adoption of ASU 2013-02 has not had a material impact on Wells Timberland REIT's financial statements or disclosures.

In June 2013, FASB issued Accounting Standards Update 2013-08, Financial Services - Investment Companies: Amendments to the Scope, Measurement, and Disclosure Requirements ("ASU 2013-08"). ASU 2013-08 clarifies the characteristics of an investment company and requires an investment company to measure noncontrolling ownership interests in other investment companies at fair value rather than using the equity method of accounting. In addition, an entity is required to disclose (a) the fact that it is an investment company applying the guidance in the Financial Services - Investment Companies Topic, (b) information about any changes in the entity's status as an investment company, and (c) information about financial support provided to its investees. ASU 2013-08 will be effective for Wells Timberland REIT for the period beginning on January 1, 2014. Wells Timberland REIT expects that the adoption of ASU 2013-08 will not have a material impact on its financial statements or disclosures.

In July 2013, FASB issued Accounting Standards Update 2013-10, Derivatives and Hedging: Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes ("ASU 2013-10"). ASU 2013-10 permits the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) to be used as a U.S. benchmark interest rate for hedge accounting purposes under the Derivatives and Hedging Topic, in addition to the U.S. Treasury rate and LIBOR. In addition, the restriction on using different benchmark rates for similar hedges is removed. ASU 2013-10 will be effective prospectively for Wells Timberland REIT for qualifying new hedging relationships entered into on or after July 17, 2013. Wells Timberland REIT expects that the adoption of ASU 2013-10 will not have a material impact on its financial statements or disclosures.

In July 2013, FASB issued Accounting Standards Update 2013-11, Income Taxes: Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists ("ASU 2013-11"). ASU 2013-11 requires an entity to present an unrecognized tax benefit in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date or not intended to be used to settle any additional income taxes that would result in the disallowance of a tax position in which case the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. ASU 2013-11 will be effective prospectively for Wells Timberland REIT for the period beginning on January 1, 2014. Wells Timberland REIT expects that the adoption of ASU 2013-11 will not have a material impact on its financial statements or disclosures.

3. Timber Assets

During the three months ended June 30, 2013 and 2012, Wells Timberland REIT sold approximately 600 acres and 5,800 acres of timberland, respectively, for approximately \$1.3 million and \$10.6 million, respectively. Wells Timberland REIT's cost basis in the timberland sold was approximately \$0.9 million and \$7.0 million, respectively.

During the six months ended June 30, 2013 and 2012, Wells Timberland REIT sold approximately 900 acres and 5,800 acres of timberland, respectively, for approximately \$1.9 million and \$10.6 million, respectively. Wells Timberland REIT's cost basis in the timberland sold was approximately \$1.2 million and \$7.0 million, respectively.

As of June 30, 2013 and December 31, 2012, timber and timberlands consisted of the following, respectively:

	As of June 30, 2013		
	Gross	Accumulated Depletion or Amortization	Net
Timber	\$ 149,947,162	4,293,257	\$ 145,653,905

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Timberlands	182,909,362	—	182,909,362
Mainline roads	467,318	205,837	261,481
Timber and timberlands	\$333,323,842	\$4,499,094	\$328,824,748

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	As of December 31, 2012		
	Gross	Accumulated Depletion or Amortization	Net
Timber	\$ 161,878,914	\$ 11,677,229	\$ 150,201,685
Timberlands	183,349,545	—	183,349,545
Mainline roads	428,688	174,623	254,065
Timber and timberlands	\$ 345,657,147	\$ 11,851,852	\$ 333,805,295

4. Note Payable and Line of Credit

Wells Timberland REIT entered into a first mortgage loan agreement (the "CoBank Loan") on September 28, 2012 with a syndicate of banks with CoBank, ACB ("CoBank") serving as administrative agent. Under the CoBank Loan, Wells Timberland REIT initially can borrow up to \$148.0 million in principal, including \$133.0 million through a term loan facility ("CoBank Term Loan") and up to \$15.0 million through a revolving credit facility (the "CoBank Revolver"). On August 11, 2018, all outstanding principal, interest, and any fees or other obligations on the CoBank Loan will be due and payable in full. The CoBank Loan is secured by a first mortgage in the Mahrt Timberland, a first priority security interest in all bank accounts held by Wells Timberland REIT, and a first priority security interest on all other assets of Wells Timberland REIT. As of June 30, 2013, the outstanding balance of the CoBank Loan was \$132.4 million, all of which was outstanding under the CoBank Term Loan.

The CoBank Loan contains certain financial covenants. Wells Timberland REIT believes it was in compliance with the financial covenants of the CoBank Loan as of June 30, 2013.

During the three months ended June 30, 2013 and 2012, Wells Timberland REIT made interest payments on its borrowings of approximately \$0.8 million and \$0.8 million, respectively. During the six months ended June 30, 2013 and 2012, interest payments on its borrowings totaled approximately \$1.5 million and \$1.7 million, respectively.

As of June 30, 2013, the weighted-average interest rate on the aforementioned borrowings, after consideration of an interest rate swap (see Note 5), was 2.63%. As of June 30, 2013 and December 31, 2012, the fair value of Wells Timberland REIT's outstanding debt approximated its book value. The fair value was estimated based on discounted cash flow analysis using the current market borrowing rates for similar types of borrowing arrangements as of the measurement dates.

5. Interest Rate Swaps

Wells Timberland REIT entered into interest rate swap contracts in order to mitigate its interest rate risk on related financial instruments. Wells Timberland REIT does not enter into derivative or interest rate contracts for speculative purposes; however, Wells Timberland REIT's derivatives may not qualify for hedge accounting treatment.

Interest Rate Swap Designated as Hedging Instrument

As required by the terms of the CoBank Loan, on October 23, 2012, Wells Timberland REIT entered into an interest rate swap agreement with Rabobank Group ("Rabobank") to hedge its exposure to changing interest rates on \$80.0 million of the CoBank Loan that is subject to a variable interest rate (the "Rabobank Forward Swap"). The Rabobank Forward Swap had an effective date of March 28, 2013 and matures on September 30, 2017. Under the terms of the Rabobank Forward Swap, Wells Timberland REIT pays interest at a fixed rate of 0.9075% per annum to Rabobank and receives one-month LIBOR-based interest payments from Rabobank. The Rabobank Forward Swap qualifies for hedge accounting treatment.

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During the three months and six months ended June 30, 2013, Wells Timberland REIT recognized a change in fair value of the Rabobank Forward Swap of approximately \$1.5 million and \$1.5 million, respectively, as other comprehensive income. There was no hedge ineffectiveness on the Rabobank Forward Swap required to be recognized in current earnings. Net payments of approximately \$0.1 million made under the Rabobank Forward Swap by Wells Timberland REIT during the three months ended June 30, 2013 were recorded as interest expense. No amounts were paid or received on the Rabobank Forward Swap during the first quarter.

Interest Rate Swap Not Designated as Hedging Instrument

On March 24, 2010, as required by the terms of its loan agreement, Wells Timberland REIT entered into an interest rate swap agreement with Rabobank to hedge its exposure to changing interest rates on a portion of its \$211.0 million senior loan (the "Rabobank Interest Rate Swap"). The Rabobank Interest Rate Swap was effective from September 30, 2010 to March 28, 2013. During the term of the Rabobank Interest Rate Swap, Wells Timberland REIT paid interest at a fixed rate of 2.085% per annum and received variable LIBOR-based interest payments from Rabobank on the following notional amounts during the periods presented:

Start Date	End Date	Notional Amount
December 30, 2011	March 30, 2012	\$62,500,000
March 30, 2012	June 29, 2012	\$57,500,000
December 31, 2012	March 28, 2013	\$28,500,000

The detail of loss on the Rabobank Interest Rate Swap, which was recorded as loss on interest rate swaps in the accompanying consolidated statements of operations, is provided below for the three months and six months ended June 30, 2013 and 2012:

	Three Months Ended		Six Months Ended	
	June 30, 2013	2012	June 30, 2013	2012
Noncash gain on Rabobank Interest Rate Swap	\$—	\$256,052	\$128,934	\$451,716
Net payments on Rabobank Interest Rate Swap	—	(268,224)	(129,408)	(554,881)
Loss on Rabobank Interest Rate Swap	\$—	\$(12,172)	\$(474)	\$(103,165)

6. Commitments and Contingencies

MeadWestvaco Timber Agreements

In connection with its acquisition of the Mahrt Timberland, Wells Timberland REIT entered into a fiber supply agreement and a master stumpage agreement (collectively, the "Timber Agreements") with a wholly owned subsidiary of MeadWestvaco Corporation ("MeadWestvaco"). The fiber supply agreement provides that MeadWestvaco will purchase specified tonnage of timber from Wells Timberland TRS at specified prices per ton, depending upon the type of timber. The fiber supply agreement is subject to quarterly market pricing adjustments based on an index published by Timber Mart-South, a quarterly trade publication that reports raw forest product prices in 11 southern states. The master stumpage agreement provides that Wells Timberland REIT will sell specified amounts of timber and make available certain portions of the Mahrt Timberland to Wells Timberland TRS for harvesting at \$0.10 per ton of qualifying timber purchased by MeadWestvaco plus a portion of the gross proceeds received from MeadWestvaco under the fiber supply agreement. The initial term of the Timber Agreements is October 9, 2007 through December 31, 2032, subject to extension and early termination provisions. The Timber Agreements ensure a long-term source of supply of wood fiber products for MeadWestvaco in order to meet its paperboard and lumber production requirements at specified mills and provide Wells Timberland REIT with a reliable customer for the wood products from the Mahrt Timberland.

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FRC Timberland Operating Agreement

Wells Timberland REIT is party to a timberland operating agreement with Forest Resource Consultants, Inc. ("FRC"). Pursuant to the terms of the timberland operating agreement, FRC manages and operates the Mahrt Timberland and the related timber operations, including ensuring delivery of timber to MeadWestvaco in compliance with the Timber Agreements. In consideration for rendering the services described in the timberland operating agreement, Wells Timberland REIT pays FRC (i) a monthly management fee based on the actual acreage FRC manages, which is payable monthly in advance, and (ii) an incentive fee based on net revenues generated by the Mahrt Timberland. The incentive fee is payable annually in arrears. The timberland operating agreement, as amended, is effective through December 31, 2013, with the option to extend for one-year periods and may be terminated by either party with mutual consent or by Wells Timberland REIT with or without cause upon providing 120 days' prior written notice.

Litigation

From time to time, Wells Timberland REIT may be a party to legal proceedings that arise in the ordinary course of its business. Management makes assumptions and estimates concerning the likelihood and amount of any reasonably possible loss relating to these matters using the latest information available. Wells Timberland REIT records a liability for litigation if an unfavorable outcome is probable and the amount of loss or range of loss can be reasonably estimated. If an unfavorable outcome is probable and a reasonable estimate of the loss is a range, Wells Timberland REIT accrues the best estimate within the range. If no amount within the range is a better estimate than any other amount, Wells Timberland REIT accrues the minimum amount within the range. If an unfavorable outcome is probable but the amount of the loss cannot be reasonably estimated, Wells Timberland REIT discloses the nature of the litigation and indicates that an estimate of the loss or range of loss cannot be made. If an unfavorable outcome is reasonably possible and the estimated loss is material, Wells Timberland REIT discloses the nature and estimate of the possible loss of the litigation. Wells Timberland REIT does not disclose information with respect to litigation where an unfavorable outcome is considered to be remote.

Wells Timberland REIT is not currently involved in any legal proceedings of which the outcome is reasonably likely to have a material adverse effect on the results of operations or financial condition of Wells Timberland REIT. Wells Timberland REIT is not aware of any legal proceedings contemplated by governmental authorities.

7. Share Redemption Plan

Wells Timberland REIT's SRP, as amended on August 6, 2012 (the "Amended SRP"), allows stockholders who hold their shares for more than one year to sell their shares back to Wells Timberland REIT, subject to certain limitations and penalties. The Amended SRP is funded through a combination of proceeds received from the sale of shares through the DRP plus any additional amounts reserved for redemptions by Wells Timberland REIT's board of directors. Wells Timberland REIT's board of directors has approved a monthly, non-cumulative reserve of \$150,000 for redemptions in connection with death, qualifying disability, or qualification for federal assistance for confinement to a long-term care facility ("Qualified Special Redemptions"). As of June 30, 2013, Wells Timberland REIT has not received any proceeds from sales of shares through the DRP, and therefore, it is currently restricted from redeeming shares of its common stock other than Qualified Special Redemptions. Qualified Special Redemptions do not require a one-year holding period.

Effective January 1, 2013, the price to be paid for shares redeemed under the Amended SRP is \$6.23 per share, which represents 95% of the most recently published estimated per-share value of Wells Timberland REIT's common stock. The estimated per-share value utilized for purposes of the Amended SRP was as of September 30, 2012. While Wells Timberland REIT is required by Financial Industry Regulatory Authority ("FINRA") rules to update this estimate 18 months from the date of last valuation, it may elect to do so sooner. As disclosed in connection with Wells Timberland

REIT's initial publication of its estimated per-share value, the estimated value of its common stock will fluctuate over time in response to market conditions, capital markets activities, attributes specific to Mahrt Timberland, and other factors. Therefore, the estimated per-share value of Wells Timberland REIT's common stock as of September 30, 2012 does not represent current value.

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During the three months and six months ended June 30, 2013, approximately 9,906 and 45,233 shares of common stock, respectively, were redeemed for approximately \$61,715 and \$281,800, respectively. The board of directors may amend, suspend, or terminate the SRP upon 30 days' written notice and without stockholder approval.

8. Supplemental Disclosures of Noncash Activities