

Wells Timberland REIT, Inc.  
Form 10-Q  
August 07, 2012  
UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-Q

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(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, 2012

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

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(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, 2012: 31,818,034 shares

FORM 10-Q  
WELLS TIMBERLAND REIT, INC.  
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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 Wells Timberland REIT’s Annual Report on Form 10-K for the year ended December 31, 2011, 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, 2011 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, 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, 2011. Wells Timberland REIT's results of operations for the three months and six months ended June 30, 2012 are not necessarily indicative of the operating results expected for the full year.

WELLS TIMBERLAND REIT, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

|  | (Unaudited)<br>June 30,<br>2012 | December 31,<br>2011 |
|--|---------------------------------|----------------------|
| Assets:  |                                 |                      |
| Cash and cash equivalents  | \$18,311,104                    | \$6,848,973          |
| Restricted cash and cash equivalents   | 2,599,924                       | 6,762,246            |
| Accounts receivable  | 823,831                         | 644,622              |
| Prepaid expenses and other assets  | 327,769                         | 499,188              |
| Deferred financing costs, less accumulated amortization of \$1,068,678 and \$809,158 as of June 30, 2012 and December 31, 2011, respectively                                   | 1,413,030                       | 1,672,550            |
| Timber assets, at cost:  |                                 |                      |
| Timber and timberlands, net (Note 3)   | 316,538,821                     | 328,561,850          |
| Intangible lease assets, less accumulated amortization of \$786,896 and \$703,675 as of June 30, 2012 and December 31, 2011, respectively                                      | 249,957                         | 333,178              |
| Total assets   | \$340,264,436                   | \$345,322,607        |
| Liabilities:   |                                 |                      |
| Accounts payable and accrued expenses  | \$1,566,652                     | \$1,918,281          |
| Due to affiliates (Note 7)   | 1,648,503                       | 28,960,573           |
| Other liabilities  | 2,527,340                       | 2,609,809            |
| Note payable and line of credit (Note 4)   | 118,397,219                     | 122,025,672          |
| Total liabilities  | 124,139,714                     | 155,514,335          |
| Commitments and Contingencies (Note 5)   |                                 |                      |
| Stockholders' Equity:  |                                 |                      |
| Preferred stock, \$0.01 par value; 100,000,000 shares authorized:  |                                 |                      |
| Series A preferred stock, \$1,000 liquidation preference; 27,585 and 27,844 shares issued and outstanding as of June 30, 2012 and December 31, 2011, respectively              | 36,337,385                      | 36,539,548           |
| Series B preferred stock, \$1,000 liquidation preference; 9,807 and 9,904 shares issued and outstanding as of June 30, 2012 and December 31, 2011, respectively                | 12,074,689                      | 12,145,951           |
| Common stock, \$0.01 par value; 900,000,000 shares authorized; 31,819,187 and 31,465,274 shares issued and outstanding as of June 30, 2012 and December 31, 2011, respectively | 318,192                         | 314,653              |
| Additional paid-in capital   | 301,733,441                     | 271,428,671          |
| Accumulated deficit and distributions  | (134,338,985 )                  | (130,620,551 )       |
| Total stockholders' equity   | 216,124,722                     | 189,808,272          |
| Total liabilities and stockholders' equity   | \$340,264,436                   | \$345,322,607        |
| See accompanying notes.  |                                 |                      |

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

|   | (Unaudited)<br>Three Months Ended |                | (Unaudited)<br>Six Months Ended |                |
|---|-----------------------------------|----------------|---------------------------------|----------------|
|   | June 30,<br>2012                  | 2011           | June 30,<br>2012                | 2011           |
| Revenues:   |                                   |                |                                 |                |
| Timber sales  | \$7,062,469                       | \$9,153,844    | \$14,284,696                    | \$17,848,278   |
| Timberland sales  | 10,552,180                        | 1,021,200      | 10,552,180                      | 1,021,200      |
| Other revenues  | 677,644                           | 688,413        | 1,341,281                       | 1,370,788      |
|   | 18,292,293                        | 10,863,457     | 26,178,157                      | 20,240,266     |
| Expenses:   |                                   |                |                                 |                |
| Contract logging and hauling costs                              | 3,849,424                         | 5,299,559      | 7,846,384                       | 9,961,306      |
| Depletion   | 2,494,011                         | 2,857,962      | 5,474,288                       | 6,081,622      |
| Cost of timberland sales  | 7,567,615                         | 712,307        | 7,567,615                       | 712,307        |
| Advisor fees and expense reimbursements                         | 1,648,503                         | 204,803        | 2,393,745                       | 1,843,958      |
| Forestry management fees  | 570,297                           | 687,776        | 1,143,079                       | 1,376,982      |
| General and administrative expenses                             | 572,510                           | 514,989        | 1,127,515                       | 1,226,836      |
| Land rent expense   | 498,419                           | 588,338        | 1,013,297                       | 1,123,438      |
| Other operating expenses  | 568,410                           | 629,618        | 1,266,358                       | 1,360,351      |
|   | 17,769,189                        | 11,495,352     | 27,832,281                      | 23,686,800     |
| Operating income (loss)   | 523,104                           | (631,895 )     | (1,654,124 )                    | (3,446,534 )   |
| Other income (expense):   |                                   |                |                                 |                |
| Interest income   | 182                               | 617            | 309                             | 1,754          |
| Interest expense  | (975,420 )                        | (1,390,015 )   | (1,961,393 )                    | (3,039,699 )   |
| Loss on interest rate swap                                      | (12,172 )                         | (325,651 )     | (103,165 )                      | (336,391 )     |
|   | (987,410 )                        | (1,715,049 )   | (2,064,249 )                    | (3,374,336 )   |
| Net loss  | (464,306 )                        | (2,346,944 )   | (3,718,373 )                    | (6,820,870 )   |
| Dividends to preferred stockholders                             | (92,970 )                         | (446,836 )     | (186,011 )                      | (1,361,231 )   |
| Net loss available to common stockholders                       | \$(557,276 )                      | \$(2,793,780 ) | \$(3,904,384 )                  | \$(8,182,101 ) |
| Per-share information—basic and diluted:                        |                                   |                |                                 |                |
| Net loss available to common stockholders                       | \$(0.02 )                         | \$(0.10 )      | \$(0.12 )                       | \$(0.30 )      |
| Weighted-average common shares<br>outstanding—basic and diluted | 31,884,699                        | 27,746,506     | 31,869,820                      | 27,172,684     |
| See accompanying notes.   |                                   |                |                                 |                |

WELLS TIMBERLAND REIT, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
FOR THE SIX MONTHS ENDED JUNE 30, 2012 AND 2011 (UNAUDITED)

|  | Common Stock |           | Preferred Stock |              | Additional<br>Paid-In<br>Capital | Accumulated<br>Deficit and<br>Distributions | Total<br>Stockholders'<br>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)                         |
| 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                    |

|  | Common Stock |           | Preferred Stock |              | Additional<br>Paid-In<br>Capital | Accumulated<br>Deficit and<br>Distributions | Total<br>Stockholders'<br>Equity |
|--|--------------|-----------|-----------------|--------------|----------------------------------|---|----------------------------------|
|  | Shares       | Amount    | Shares          | Amount       |                                  |   |                                  |
| Balance, December 31, 2010   | 25,498,717   | \$254,988 | 43,628          | \$54,648,732 | \$219,082,323                    | \$(113,326,358)                             | \$160,659,685                    |
| Issuance of common stock   | 2,354,797    | 23,548    | —               | —            | 23,532,756                       | —   | 23,556,304                       |
| Issuance of stock dividends  | 264,610      | 2,646     | —               | —            | 2,655,523                        | (2,658,184)                                 | (15)                             |
| Redemptions of common stock  | (40,165)     | (402)     | —               | —            | (388,599)                        | —   | (389,001)                        |
| Dividends on preferred stock   | —            | —         | —               | 1,361,231    | (1,361,231)                      | —   | —                                |
| Redemptions of preferred stock   | —            | —         | (2,781)         | (3,531,792)  | —                                | —   | (3,531,792)                      |
| Commissions and discounts on stock sales and related dealer-manager fees | —            | —         | —               | —            | (2,070,679)                      | —   | (2,070,679)                      |
| Other offering costs   | —            | —         | —               | —            | (280,232)                        | —   | (280,232)                        |
| Net loss   | —            | —         | —               | —            | —                                | (6,820,870)                                 | (6,820,870)                      |
| Balance, June 30, 2011   | 28,077,959   | \$280,780 | 40,847          | \$52,478,171 | \$241,169,861                    | \$(122,805,412)                             | \$171,123,400                    |

See accompanying notes.

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

|   | (Unaudited)      |                |
|---|------------------|----------------|
|   | Six Months Ended |                |
|   | June 30,         |                |
|   | 2012             | 2011           |
| Cash Flows from Operating Activities:   |                  |                |
| Net loss  | \$(3,718,373 )   | \$(6,820,870 ) |
| Adjustments to reconcile net loss to net cash provided by operating activities: |                  |                |
| Depletion   | 5,474,288        | 6,081,622      |
| Unrealized gain on interest rate swaps  | (451,716 )       | (111,434 )     |
| Other amortization  | 111,176          | 107,227        |
| Stock-based compensation expense  | 8,333            | 8,333          |
| Noncash interest expense  | 259,520          | 223,127        |
| Basis of timberland sold  | 6,962,273        | 628,229        |
| Changes in assets and liabilities:  |                  |                |
| Increase in accounts receivable   | (179,209 )       | (143,420 )     |
| Decrease in prepaid expenses and other assets                                   | 181,430          | 301,663        |
| Decrease in accounts payable and accrued expenses                               | (351,629 )       | (788,514 )     |
| Increase in due to affiliates   | 168,307          | 1,828,448      |
| Increase in other liabilities   | 369,247          | 1,062,140      |
| Net cash provided by operating activities                                       | 8,833,647        | 2,376,551      |
| Cash Flows from Investing Activities:   |                  |                |
| Investment in timber, timberland, and related assets                            | (451,498 )       | (324,090 )     |
| Funds released from escrow accounts   | 4,162,322        | 3,366,056      |
| Net cash provided by investing activities                                       | 3,710,824        | 3,041,966      |
| Cash Flows from Financing Activities:   |                  |                |
| Financing costs paid  | —                | (168,380 )     |
| Repayments of Mahrt loan  | (3,628,453 )     | (24,767,554 )  |
| Issuance of common stock  | 4,062,646        | 23,352,636     |
| Redemptions of common stock   | (525,614 )       | (389,001 )     |
| Redemptions of preferred stock  | (356,000 )       | (2,781,000 )   |
| Dividends paid on preferred stock redeemed                                      | (103,436 )       | (750,792 )     |
| Commissions on stock sales and related dealer-manager fees paid                 | (447,744 )       | (1,901,813 )   |
| Other offering costs paid   | (83,739 )        | (284,408 )     |
| Placement and structuring agent fees paid                                       | —                | (93,264 )      |
| Net cash used in financing activities   | (1,082,340 )     | (7,783,576 )   |
| Net increase (decrease) in cash and cash equivalents                            | 11,462,131       | (2,365,059 )   |
| Cash and cash equivalents, beginning of period                                  | 6,848,973        | 8,788,967      |
| Cash and cash equivalents, end of period  | \$18,311,104     | \$6,423,908    |
| See accompanying notes.   |                  |                |

WELLS TIMBERLAND REIT, INC. AND SUBSIDIARIES  
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2012 (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 acquisition and ownership 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. 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, and 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 7).

As of June 30, 2012, Wells Timberland REIT owned approximately 216,600 acres of timberland and held long-term leasehold interests in approximately 72,700 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 (“HBU”) 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”), pursuant to a Registration Statement filed on Form S-11 under the Securities Act. 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, pursuant to a Registration Statement filed on Form S-11 under the Securities Act. 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 pursuant to Regulation S under the Securities Act 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.

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

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, 2011.

### Interest Rate Swaps

Wells Timberland REIT has entered into interest rate swap agreements to hedge its exposure to changing interest rates on variable rate debt instruments (see Note 4). 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 will be recorded as other comprehensive income or loss in a consolidated statement of other comprehensive income. The ineffective portion of the hedge, if any, is recognized in current earnings during the period of change in fair value. Changes in the fair value of interest rate swaps that do not qualify for hedge accounting treatment are recorded as gain or loss on interest rate swap in the accompanying 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 or loss on interest rate swap for contracts that do not qualify for hedge accounting treatment.

As of June 30, 2012 and December 31, 2011, Wells Timberland REIT recognized the fair value of an interest rate swap that does not qualify for hedge accounting treatment of approximately \$0.5 million and \$1.0 million, respectively, in other liabilities. The detail of loss on the interest rate swap, which was recorded in the accompanying consolidated statements of operations, is provided below for the three months and six months ended June 30, 2012 and 2011, respectively:

|   | Three Months Ended |             | Six Months Ended |             |
|---|--------------------|-------------|------------------|-------------|
|   | June 30,           |             | June 30,         |             |
|   | 2012               | 2011        | 2012             | 2011        |
| Noncash gain (loss) on interest rate swap | \$256,052          | \$(103,580) | \$451,716        | \$111,434   |
| Net payments on interest rate swap        | (268,224)          | (222,071)   | (554,881)        | (447,825)   |
| Loss on interest rate swap                | \$(12,172)         | \$(325,651) | \$(103,165)      | \$(336,391) |

#### 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 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.

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 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 timber 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 least of (a) the excess of the fair market value of the timber assets disposed of as of the REIT commencement date over its basis in the timber assets as of the REIT commencement date (the built-in gain with respect to that timberland 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 timber assets as of the REIT commencement date not already recognized during the ten-year period. At December 31, 2011, Wells Timberland REIT had federal and state net operating loss carryforwards of approximately \$99.7 million and \$83.6 million, respectively. Such net operating loss carryforwards may be utilized, subject to certain limitations, to offset future taxable income, including net built-in gains.

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. Wells Timberland REIT is subject to certain state and local taxes related to its operations in certain locations, which have been provided for in the accompanying consolidated financial statements.

#### 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.

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; instruments valued based on the best available data, some of which is internally-developed, and considers risk premiums that a market participant would require.

Wells Timberland REIT applied the provisions of the accounting standard for fair value measurements and disclosures in recording its interest rate swap at fair value and to estimations of fair value of its debt instruments based on Level 2 assumptions. The fair values of the interest rate swap were determined using a proprietary model which 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 the counterparties and reasonable estimates about relevant future market conditions.

The following table presents information about Wells Timberland REIT’s assets and liabilities measured at fair value and recorded in the accompanying consolidated balance sheets as of June 30, 2012 and December 31, 2011, and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value:

|                    | Fair Value Measurements as of June 30, 2012     |         |           |         |
|--------------------|---|---------|-----------|---------|
|                    | Total   | Level 1 | Level 2   | Level 3 |
| Liabilities:       |   |         |           |         |
| Interest rate swap | \$524,961                                       | \$—     | \$524,961 | \$—     |
|                    | Fair Value Measurements as of December 31, 2011 |         |           |         |
|                    | Total   | Level 1 | Level 2   | Level 3 |
| Liabilities:       |   |         |           |         |
| Interest rate swap | \$976,677                                       | \$—     | \$976,677 | \$—     |

#### Recent Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update 2011-04, Fair Value Measurement (Topic 820) Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS (“ASU 2011-04”). ASU 2011-04 converges the GAAP and International



Financial Reporting Standards definition of “fair value”, the requirements for measuring amounts at fair value, and disclosures about these measurements. The update does not require additional fair value measurements and is not intended to

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establish valuation standards or affect valuation practices outside of financial reporting. The adoption of ASU 2011-04 was effective for Wells Timberland REIT for the interim period beginning January 1, 2012. The adoption of ASU 2011-04 has not had a material impact on Wells Timberland REIT's financial statements or disclosures.

In June 2011, the FASB issued Accounting Standards Update 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income ("ASU 2011-05"). ASU 2011-05 gives an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. The adoption of ASU 2011-05 was effective for Wells Timberland REIT for the interim period beginning January 1, 2012, except for the specific requirement to present items that are reclassified from other comprehensive income to net income alongside their respective components of net income and other comprehensive income that has been deferred indefinitely. The adoption of ASU 2011-05 did not have a material impact on Wells Timberland REIT's consolidated financial statements or disclosures.

### 3. Timber and Timberlands

As of June 30, 2012 and December 31, 2011, timber and timberlands consisted of the following, respectively:

|                        | As of June 30, 2012     |   |                |
|------------------------|-------------------------|---|----------------|
|                        | Gross                   | Accumulated<br>Depletion or<br>Amortization | Net            |
| Timber                 | \$ 161,467,625          | \$ 5,474,288                                | \$ 155,993,337 |
| Timberlands            | 160,294,227             | —   | 160,294,227    |
| Mainline roads         | 396,875                 | 145,618                                     | 251,257        |
| Timber and timberlands | \$ 322,158,727          | \$ 5,619,906                                | \$ 316,538,821 |
|                        | As of December 31, 2011 |   |                |
|                        | Gross                   | Accumulated<br>Depletion or<br>Amortization | Net            |
| Timber                 | \$ 175,512,118          | \$ 11,759,282                               | \$ 163,752,836 |
| Timberlands            | 164,550,798             | —   | 164,550,798    |
| Mainline roads         | 376,406                 | 118,190                                     | 258,216        |
| Timber and timberlands | \$ 340,439,322          | \$ 11,877,472                               | \$ 328,561,850 |

During the three months ended June 30, 2012 and 2011, Wells Timberland REIT sold approximately 5,800 acres and 550 acres, respectively, of HBU timberland for approximately \$10.6 million and \$1.0 million, respectively. Wells Timberland REIT did not sell any HBU timberland during the first quarter of 2012 and 2011.

### 4. Note Payable and Line of Credit

#### Note Payable

Wells Timberland REIT entered into a five-year senior loan agreement for \$211.0 million (the "Mahrt Loan") with CoBank, ACB ("CoBank") and Wells Fargo Securities, LLC serving as co-lead lenders on March 24, 2010. The Mahrt Loan bears interest at an adjustable rate based on one-, two-, or three-month LIBOR plus a margin of 2.5% to 4.0%

that varies based upon the loan-to-collateral value ratio at the time of determination. The loan-to-collateral-value ratio

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(the “LTV Ratio”) is defined as the ratio, expressed as a percentage, of (a) the outstanding principal amount of all loans outstanding under a second amendment to the Mahrt Loan agreement as of the measurement date, less certain amounts permitted to be set aside under the terms of the Mahrt Loan agreement, as amended, for working capital and other purposes and any cash balances accumulated to fund distributions or future acquisitions, to (b) the value of the timberland assets, as determined in accordance with the Mahrt Loan agreement, as amended. The Mahrt Loan may be voluntarily prepaid at any time. On March 24, 2015, all outstanding principal, interest, and any fees or other obligations on the Mahrt Loan will be due and payable in full.

#### Line of Credit

Wells Timberland REIT entered into a \$15.0 million secured revolving credit facility (the “Mahrt Credit Facility”) with three of the Mahrt Loan lenders (the “Lenders”) pursuant to a second amendment to the Mahrt Loan agreement on June 10, 2011. Under the Mahrt Credit Facility, Wells Timberland REIT may borrow up to \$15.0 million, subject to certain limitations. Loans under the Mahrt Credit Facility can be either a base rate loan or a LIBOR rate loan. Base rate loans bear interest at the higher of (1) the prime rate, or (2) one-month LIBOR plus 1.5%. LIBOR rate loans bear interest at one-, two-, or three-month LIBOR (depending upon the applicable term of the loan) plus a range of 2.5% to 4.0% depending on Wells Timberland REIT’s then-current LTV Ratio. The Mahrt Credit Facility terminates upon the earliest of (1) the occurrence of an event of default under the Mahrt Loan agreement, as amended, (2) the reduction of all amounts permitted to be borrowed under the Mahrt Credit Facility (either by Wells Timberland REIT or by the Lenders), or (3) March 24, 2015. As of June 30, 2012, no amounts had been borrowed under the Mahrt Credit Facility.

#### Mandatory Prepayments and Loan Covenants

The Mahrt Loan and Mahrt Credit Facility (collectively, the “Mahrt Debt”) is subject to mandatory prepayments from (1) proceeds generated from sales or other dispositions of timber until reduction of the Mahrt Debt to an LTV Ratio of less than 40%, and (2) proceeds generated from dispositions of timberland and lease terminations excluding (a) the first \$4.0 million of cost basis of timberland dispositions in any fiscal year if (i) the LTV Ratio calculated on a pro forma basis after giving effect to such disposition, does not exceed 40%, and (ii) such cost basis is used as permitted under the Mahrt Loan agreement; and (b) lease termination proceeds of less than \$2.0 million in a single termination until aggregate lease termination proceeds during the term of the Mahrt Debt exceed \$5.0 million. Pursuant to the mandatory prepayment requirement, Wells Timberland REIT paid down the Mahrt Loan by approximately \$3.6 million during the second quarter of 2012 with proceeds from timberland sales.

The Mahrt Loan agreement and its amendments (collectively, the “Amended Mahrt Loan Agreement”) contains, among others, the following restrictive and financial covenants:

- requires a fixed-charge coverage ratio of not less than 1.05:1.00 at all times;
- limits the LTV Ratio to 45%; and
  - requires funding of an account under the control of CoBank equal to approximately six months of interest on the Mahrt Debt during any time the LTV Ratio is 30% or greater. Once the LTV Ratio is less than 30%, the required funding will decrease to an amount equal to three months of interest on the Mahrt Debt.

Wells Timberland REIT believes it was in compliance as of June 30, 2012 and expects to remain in compliance with the restrictive and financial covenants of the Amended Mahrt Loan Agreement.

#### Interest Paid and Fair Value of Outstanding Debt

During the three months ended June 30, 2012 and 2011, after consideration of the interest rate swap, Wells Timberland REIT made interest payments of approximately \$1.1 million and \$1.5 million, respectively, on the Mahrt Loan. During the six months ended June 30, 2012 and 2011, interest payments totaled approximately \$2.3 million and

\$3.3 million.

As of June 30, 2012, the weighted-average interest rate of the Mahrt Loan after consideration of the interest rate swap

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was 3.52%. As of June 30, 2012 and December 31, 2011, the estimated fair value of Wells Timberland REIT's note payable was approximately \$118.4 million and \$118.4 million, respectively. 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. The discounted cash flow method of assessing fair value results in a general approximation of value, and such value may never actually be realized.

## 5. 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.

### 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, 2012, 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 180 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

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Timberland REIT is not aware of any legal proceedings contemplated by governmental authorities.

#### 6. Supplemental Disclosures of Noncash Activities

Outlined below are significant noncash investing and financing transactions for the six months ended June 30, 2012 and 2011, respectively:

|  | Six Months Ended |             |
|--|------------------|-------------|
|  | June 30,<br>2012 | 2011        |
| Write-off of due to affiliates                                       | \$27,315,249     | \$—         |
| Dividends accrued on preferred stock                                 | \$186,011        | \$1,361,231 |
| Discounts applied to issuance of common stock                        | \$43,761         | \$195,335   |
| Issuance of stock dividends  | \$61             | \$2,643,033 |
| Stock dividends payable to stockholders – additional paid-in capital | \$—              | \$15,136    |
| Stock dividends payable to stockholders – par value                  | \$—              | \$15        |

#### 7. Related-Party Transactions

##### Advisory Agreement

Wells Timberland REIT and Wells Timberland OP are party to the Advisory Agreement with Wells TIMO, a wholly owned subsidiary of Wells Capital. On March 16, 2012, the board of directors of Wells Timberland REIT approved a second amendment to the Advisory Agreement (“Advisory Agreement Amendment No. 2”), which amended certain provisions related to fees and expense reimbursements. Advisory Agreement Amendment No. 2, which was effective April 1, 2012, provides that for each quarter, the amount of fees and expense reimbursements payable to Wells TIMO will be limited to the lesser of one-fourth of (i) 1.0% of assets under management, and (ii) free cash flow for the four quarters then ended in excess of an amount equal to 1.25 multiplied by Wells Timberland REIT’s interest expense. Free cash flow is defined as EBITDA (as defined in the Amended Mahrt Loan Agreement), less all capital expenditures paid by Wells Timberland REIT on a consolidated basis, less any cash distributions (except for the payments of accrued but unpaid dividends as a result of any redemptions of Wells Timberland REIT's outstanding preferred stock). The amount of the disposition fees and the reimbursement of organization and offering expenses payable pursuant to the Advisory Agreement, as amended, remained unchanged. No payments would be permitted under the Advisory Agreement, as amended, if they would cause a default under the Amended Mahrt Loan Agreement.

On April 1, 2011, the board of directors of Wells Timberland REIT approved an amendment to the Advisory Agreement (the “Advisory Agreement Amendment No. 1”) that limited the amount of fees and expense reimbursements to the least of: (1) the amounts noted below pursuant to the Advisory Agreement, (2) 1.5% of assets under management, or (3) all free cash flow in excess of an amount equal to 1.05 multiplied by interest on outstanding debt. Advisory Agreement Amendment No. 2 superseded Advisory Agreement Amendment No. 1.

Prior to April 1, 2011, Wells TIMO was entitled to the following fees and reimbursements pursuant to the Advisory Agreement:

Reimbursement of organization and offering costs paid by Wells TIMO and its affiliates on behalf of Wells Timberland REIT, not to exceed 1.2% of gross offering proceeds. To the extent that organization and offering costs exceed 1.2% of gross offering proceeds, all organization and offering costs will be incurred by Wells TIMO and not by Wells Timberland REIT.



- Monthly asset management fees equal to one-twelfth of 1.0% of the greater of (i) the gross cost of all investments made on behalf of Wells Timberland REIT and (ii) the aggregate value of such investments.

Reimbursement for all costs and expenses Wells TIMO incurs in fulfilling its duties as the asset portfolio manager, including wages, salaries, and other employee-related expenses of Wells TIMO's employees engaged in the management, administration, operations, and marketing functions. Employee-related expenses include taxes, insurance, and benefits relating to such employees, and legal, travel, and other out-of-pocket expenses that are directly related to the services they provide.

For any property sold by Wells Timberland REIT, if Wells TIMO provided a substantial amount of services in connection with the sale (as determined by Wells Timberland REIT's independent directors), a fee equal to (i) for each property sold at a contract price up to \$20.0 million, up to 2.0% of the sales price, and (ii) for each property sold at a contract price in excess of \$20.0 million, up to 1.0% of the sales price. The precise amount of the fee within the preceding limits will be determined by Wells Timberland REIT's board of directors, including a majority of the independent directors, based on the level of services provided and market norms. The real estate disposition fee may be in addition to real estate commissions paid to third parties. However, the total real estate commissions (including such disposition fee) may not exceed the lesser of (i) 6.0% of the sales price of each property or (ii) the level of real estate commissions customarily charged in light of the size, type, and location of the property.

Effective July 11, 2012, the Advisory Agreement, as amended (the "Amended Advisory Agreement") was renewed through July 10, 2013, upon terms identical to those in effect through July 10, 2012. The Amended Advisory Agreement may be renewed for successive one-year terms upon the mutual consent of the parties. Wells Timberland REIT may terminate the Amended Advisory Agreement without penalty upon 60 days' written notice. If Wells Timberland REIT terminates the Amended Advisory Agreement, it will pay Wells TIMO all earned but unpaid fees. In addition, if the Amended Advisory Agreement is terminated without cause, the special units of limited partnership held by Wells TIMO will be redeemed. For further information on the special units, including redemption payments, refer to the consolidated financial statements and accompanying notes included in Wells Timberland REIT's Annual Report on Form 10-K for the year ended December 31, 2011.

Under the terms of the Amended Advisory Agreement, Wells Timberland REIT was required to reimburse Wells TIMO for certain organization and offering costs up to the lesser of actual expenses or 1.2% of gross offering proceeds raised. Wells Timberland REIT incurred and charged to additional paid-in capital cumulative organization and offering costs of approximately \$2.1 million related to the Initial Public Offering and approximately \$1.5 million related to the Follow-On Offering, the sum of which represents approximately 1.2% of cumulative gross proceeds raised by Wells Timberland REIT under the Public Offerings. As of December 31, 2011, approximately \$2.2 million of organization and offering costs incurred by Wells Timberland REIT and due to Wells TIMO had been deferred by the terms of the Amended Mahrt Loan Agreement. On January 27, 2012, Wells TIMO forgave the deferred organization and offering expenses. After adjusting for this write-off, organization and offering costs represents approximately 0.5% of cumulative gross proceeds raised under the Public Offerings. Upon the expiration of Wells Timberland REIT's Follow-On Offering on December 31, 2011, approximately \$6.4 million of organization and offering expenses related to the Follow-On Offering that had not been incurred and charged to additional paid-in capital by Wells Timberland REIT was expensed by Wells TIMO and is not subject to reimbursement by Wells Timberland REIT.

On January 20, 2012, Wells Timberland REIT entered into an agreement with Wells TIMO to forgive approximately \$25.1 million of accrued but unpaid asset management fees and expense reimbursements that were previously deferred due to restrictions under our loan agreements. Due to the related-party nature of these transactions, this amount, along with the organizational and offering costs forgiven by Wells TIMO on January 27, 2012, were recorded as additional paid-in capital during the first quarter of 2012.

#### Dealer-Manager Agreement

Wells Timberland REIT had executed a dealer-manager agreement (the “Dealer-Manager Agreement”), whereby Wells Investment Securities, Inc. (“WIS”), an affiliate of Wells Capital, performed the dealer-manager function for Wells Timberland REIT’s Public Offerings. For these services, WIS earned a commission of up to 7.0% of the gross offering proceeds from the sale of Wells Timberland REIT’s shares, of which substantially all was re-allowed to participating broker/dealers. Wells Timberland REIT pays no commissions on shares issued under its DRP.

Additionally, WIS earned a dealer-manager fee of 1.8% of the gross offering proceeds at the time the shares are sold. A portion of the dealer-manager fee was re-allowed to participating broker-dealers. Dealer-manager fees applied to the sale of shares in the primary offering only and do not apply to the sale of shares under Wells Timberland REIT's DRP.

#### Structuring Agent Agreement

Wells Timberland REIT is party to a structuring agent agreement (the "Structuring Agent Agreement") whereby Wells Germany GmbH, a limited partnership organized under the laws of Germany ("Wells Germany"), served as the structuring agent in connection with the 2010 German Offering. Wells Timberland REIT paid a structuring agent fee to Wells Germany of \$0.20 per share sold under the 2010 German Offering. The Structuring Agent Agreement expired upon the conclusion of the 2010 German Offering, provided, however, that with respect to the ongoing services contemplated by the parties, the Structuring Agent Agreement will terminate upon the earlier of (i) a liquidity event or (ii) December 31, 2018.

#### Related-Party Costs

Pursuant to the terms of the agreements described above, Wells Timberland REIT incurred the following related-party costs for the three months and six months ended June 30, 2012 and 2011, respectively:

|   | Three Months Ended<br>June 30, |             | Six Months Ended<br>June 30, |             |
|---|--------------------------------|-------------|------------------------------|-------------|
|   | 2012                           | 2011        | 2012                         | 2011        |
| Advisor fees and expense reimbursements | \$1,648,503                    | \$204,803   | \$2,393,745                  | \$1,843,958 |
| Disposition fees                        | 211,044                        | 22,774      | 211,044                      | 22,774      |
| Commissions <sup>(1)(2)</sup>           | —                              | 802,705     | 246,546                      | 1,467,470   |
| Dealer-manager fees <sup>(1)</sup>      | —                              | 224,043     | 71,057                       | 407,874     |
| Other offering costs <sup>(1)</sup>     | —                              | 155,968     | 48,752                       | 280,232     |
| Total                                   | \$1,859,547                    | \$1,410,293 | \$2,971,144                  | \$4,022,308 |

<sup>(1)</sup> Commissions, dealer-manager fees, and other offering costs were charged against stockholders' equity as incurred.

<sup>(2)</sup> Substantially all commissions were re-allowed to participating broker-dealers through the end of the Public Offerings.

Advisor fees and expense reimbursements of approximately \$1.6 million for the three months ended June 30, 2012 were determined based on assets under management, pursuant to Advisory Agreement Amendment No. 2.

#### Due to Affiliates

The detail of amounts due to affiliates is provided below as of June 30, 2012 and December 31, 2011:

|  | June 30, 2012 | December 31, 2011 |
|--|---------------|-------------------|
| Advisor fees and expense reimbursements due to Wells TIMO <sup>(1)</sup> | \$1,648,503   | \$25,504,045      |
| Other offering cost reimbursements due to Wells TIMO <sup>(2)</sup>      | —             | 2,258,696         |
| Operating expense reimbursements due to Wells TIMO <sup>(1)</sup>        | —             | 1,067,691         |
| Commissions on stock sales and related dealer-manager fees due to WIS    | —             | 130,141           |
| Total  | \$1,648,503   | \$28,960,573      |

<sup>(1)</sup> On January 20, 2012, we entered into an agreement with Wells TIMO whereby Wells TIMO forgave approximately \$25.1 million of accrued but unpaid asset management fees and reimbursements that were previously deferred due to restrictions under our loan agreements. Due to the related-party nature of this transaction, this amount was recorded as additional paid-in



capital during the first quarter of 2012.

(2) On January 27, 2012, approximately \$2.2 million of other offering cost due to Wells TIMO was forgiven. Due to the related-party nature of this transaction, this amount was recorded as additional paid-in capital during the first quarter of 2012.

#### Conflicts of Interest

As of June 30, 2012, Wells TIMO had eight employees. Until such time, if ever, as Wells TIMO hires sufficient personnel of its own to perform the services under the Amended Advisory Agreement, it will continue to rely upon employees of Wells Capital to perform many of its obligations. Wells Capital, the parent company and manager of Wells TIMO, also is a general partner or advisor of the various affiliated public real estate investment programs ("Wells Real Estate Funds"). As such, in connection with serving as a general partner or advisor for Wells Real Estate Funds and managing Wells TIMO's activities under the Amended Advisory Agreement, Wells Capital may encounter conflicts of interest with regard to allocating human resources and making decisions related to investments, operations, and disposition-related activities for Wells Timberland REIT and Wells Real Estate Funds.

Three members of Wells Timberland REIT's board of directors serve on the board of another REIT sponsored by Wells Real Estate Funds, Inc. ("Wells REF"); additionally, one of them also serves on the board of a third REIT sponsored by Wells REF. Accordingly, they may encounter certain conflicts of interest regarding investment and operational decisions.

#### Operational Dependency

Wells Timberland REIT has engaged Wells TIMO to provide certain services essential to Wells Timberland REIT, including asset management services, supervision of the management of properties owned by Wells Timberland REIT, asset acquisition and disposition services, as well as other administrative responsibilities, including accounting services, stockholder communications, and investor relations. Wells TIMO is dependent on Wells Capital to provide certain services that are essential to their operations. This agreement is terminable by either party upon 60 days' written notice. As a result of these relationships, Wells Timberland REIT's operations are dependent upon Wells Capital and Wells TIMO.

Wells Capital and Wells TIMO are all owned and controlled by Wells REF. The operations of Wells Capital, Wells TIMO, WIS, and Wells Management Company, Inc. ("Wells Management") represent substantially all of the business of Wells REF. Accordingly, Wells Timberland REIT focuses on the financial condition of Wells REF when assessing the financial condition of Wells Capital and Wells TIMO. In the event that Wells REF were to become unable to meet its obligations as they become due, Wells Timberland REIT might be required to find alternative service providers.

Future net income generated by Wells REF will be largely dependent upon the amount of fees earned by Wells Capital, Wells TIMO, WIS, Wells Management, and their affiliates, based on, among other things, real estate assets managed, the amount of investor proceeds raised, and the volume of future acquisitions and dispositions of real estate assets by Wells Timberland REIT and other Wells REF-sponsored programs, as well as distribution income earned from equity interests in another REIT. As of June 30, 2012, Wells Timberland REIT had no reason to believe that Wells REF does not have access to adequate liquidity and capital resources, including cash flow generated from operations, cash on hand, other investments, and borrowing capacity, necessary to meet its current and future obligations as they become due. Modifying service agreements between Wells REF, or its affiliates, and Wells Timberland REIT, or other Wells REF-sponsored programs, could impact Wells REF's future net income and future access to liquidity and capital resources. For example, a large portion of Wells REF's income is derived under an advisory agreement with Wells Real Estate Investment Trust II, Inc. ("Wells REIT II") and Wells REF does not expect to receive significant compensation from Wells REIT II beyond December 31, 2013.



## 8. Subsequent Events

In July 2012, Wells Timberland REIT entered into an agreement to purchase timberland for approximately \$20.0 million. This transaction is expected to close during the third quarter and will be funded through a combination of cash on hand and debt financing.

On August 6, 2012, the board of directors of Wells Timberland REIT amended and restated the SRP (the "Amended SRP"), effective October 1, 2012. The Amended SRP provides that the redemption price for all redemptions, including redemptions sought within two years of a stockholder's death, qualifying disability or confinement to a long-term care facility, will be calculated in the same manner. Specifically, until the initial publication in an Exchange Act report filed with the SEC of an estimated per share value approved by the board, the price per share will be 91% of the aggregate amount paid to Wells Timberland REIT for all shares owned by the redeeming stockholder, divided by the number of shares owned by such stockholder that were acquired from Wells Timberland REIT. After the initial estimated per share value publication, the price will be 95% of the estimated per share value, plus or minus any valuation adjustment as provided in the Amended SRP.

Also on August 6, 2012, the board of directors of Wells Timberland REIT voted to suspend the Amended SRP effective October 1, 2012 until the first full month following the initial publication of the estimated per share value.



ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with our accompanying consolidated financial statements and notes thereto. See also "Cautionary Note Regarding Forward-Looking Statements" preceding Part I, as well as our consolidated financial statements and the notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended December 31, 2011.

Overview

We engage in the acquisition and ownership of timberland properties located in the timber-producing regions of the southeastern United States. From 2007 through the first quarter of 2012, we raised approximately \$307.2 million through the issuance of our common stock in our Offerings and approximately \$43.6 million through the issuance of our preferred stock to Wells REF and, along with borrowings, invested those proceeds, net of fees, into timberland properties. As of June 30, 2012, we owned interests in approximately 289,300 acres of timberland located on the Lower Piedmont and Upper Coastal Plains of East Central Alabama and West Central Georgia, which we refer to as the Mahrt Timberland. We generate a majority of our revenues by selling timber and the right to access land and harvest timber to third parties pursuant to supply agreements and through open-market sales, from selling HBU timberland, and leasing land-use rights to third parties. A substantial portion of our timber sales are derived from the Timber Agreements under which we sell specified amounts of timber to MeadWestvaco subject to market pricing adjustments. The initial term of the Timber Agreements is from October 9, 2007 through December 31, 2032, subject to extension and early termination provisions. See Note 5 of our accompanying consolidated financial statements for additional information regarding the material terms of the Timber Agreements.

We have no paid employees and are externally advised and managed by Wells TIMO, a wholly owned subsidiary of Wells Capital. On March 16, 2012, we entered into Advisory Agreement Amendment No. 2 to amend certain provisions of the Advisory Agreement related to fees and expense reimbursements. Advisory Agreement Amendment No. 2 provides that for each quarter, the amount of advisor fees and expense reimbursements payable to Wells TIMO will be limited to the lesser of one-fourth of (i) 1.0% of assets under management, and (2) free cash flow for the four quarters then ended in excess of an amount equal to 1.25 multiplied by our interest expense. Free cash flow is defined as EBITDA (as defined in the Amended Mahrt Loan agreement), less all capital expenditures paid by us on a consolidated basis, less any cash distributions (except for the payments of accrued but unpaid dividends as a result of any redemptions of our outstanding preferred stock). Advisory Agreement Amendment No. 2, which was effective April 1, 2012, superseded a previous amendment to our Advisory Agreement entered into on April 1, 2011, referred to herein as Advisory Agreement Amendment No. 1, which provided that, as of and for each quarter, the amount of fees and expense reimbursements payable to Wells TIMO were limited to the least of: (1) the amounts currently payable under the Advisory Agreement, (2) one-fourth of 1.5% of assets under management, or (3) all free cash flow in excess of an amount equal to 1.05 multiplied by our interest expense. The amount of the disposition fees and the reimbursement of organization and offering expenses payable pursuant to the Advisory Agreement remain unchanged. No payments will be permitted under the amended Advisory Agreement if they would cause a default under the Mahrt Loan.

Subsequent to our fundraising stage, during 2012, we have concentrated our efforts on actively managing our timber assets and exploring a variety of strategic opportunities focused on enhancing the composition of our portfolio and the total return potential for Wells Timberland REIT. In doing so, we have made and will continue to make strategic acquisitions and dispositions of timberland properties.

Our operating strategy entails funding expenditures related to the recurring operations of the Mahrt Timberland, including interest on outstanding indebtedness and certain capital expenditures (excluding timberland acquisitions), with operating cash flows; assessing the amount of operating cash flows that will be required for redemptions of common stock and additional timberland acquisitions; and distributing residual operating cash flows, if any, to our stockholders. Our most significant risks and challenges include our ability to access a sufficient amount of capital that will allow us to repay or refinance the Mahrt Debt and to further grow and diversify our portfolio of timber assets. To

the extent that significant capital is not raised, we may not be able to repay the Mahrt Debt or achieve sufficient economies of scale and diversification to guard against the general economic, industry-specific, financing, and operational risks generally associated with individual investments.

## Liquidity and Capital Resources

### Overview

We ceased offering shares for sale under the Follow-On Offering effective December 31, 2011. Between January 1, 2012 and February 13, 2012, we accepted gross offering proceeds of approximately \$4.1 million from the sale of shares of our common stock under the Follow-On Offering, which sales were agreed to by the investors on or before December 31, 2011. The majority of these funds were set aside as working capital.

We entered into the Mahrt Loan in March 2010. Proceeds from the Mahrt Loan were used to refinance outstanding balances due on the senior loan and the mezzanine loan, which were obtained in connection with the acquisition of the Mahrt Timberland, and to fund costs associated with closing the Mahrt Loan. The Mahrt Loan bears interest at an adjustable rate based on LIBOR plus a margin of 2.5% to 4.0% that varies based on the LTV Ratio at the time of determination. On June 10, 2011, we entered into the Mahrt Credit Facility, which allows us to borrow up to \$15.0 million, subject to availability. The Mahrt Credit Facility bears interest at an adjustable rate based on either the prime rate, or one-, two-, or three-month LIBOR plus a range of 1.5% to 4.0% depending on the type of loan and our then-current LTV Ratio. As of June 30, 2012, no amounts had been borrowed under the Mahrt Credit Facility. The Mahrt Debt may be voluntarily prepaid at any time. As of July 31, 2012, the outstanding principal balance on the Mahrt Debt was approximately \$118.4 million, same as the balance as of June 30, 2012. We intend to maintain amounts outstanding on the Mahrt Loan in order to have more funds available for working capital and investment in timberland properties. On March 24, 2015, all outstanding principal, interest, and any fees or other obligations on the Mahrt Debt will be due and payable in full.

Net cash flows generated from our operations are required to be used to service the Mahrt Loan until attainment of certain financial measures, including an LTV Ratio of less than 40%, which we obtained in April 2011. Additionally, the Mahrt Debt requires mandatory prepayment from proceeds generated from the sale or other dispositions of the Mahrt Timberland and lease terminations, excluding (1) the first \$4.0 million of cost basis of timberland dispositions in any fiscal year if (a) the LTV Ratio calculated on a pro forma basis after giving effect to such disposition, does not exceed 40%, and (b) such cost basis is used as permitted under the Mahrt Loan agreement; and (2) lease termination proceeds of less than \$2.0 million in a single termination until aggregate lease termination proceeds during the term of the Mahrt Debt exceed \$5.0 million.

Prior to our attaining certain financial measures, the Mahrt Debt prohibited us from declaring, setting aside funds for, or paying any dividend, distribution, or other payment to our stockholders other than as required to maintain our REIT qualification. So long as our LTV Ratio remains below 40% and we maintain a minimum fixed-charge coverage ratio, of 1.05:1.00, we have the ability to declare, set aside funds for, pay dividends or distributions, or make other payments to our stockholders from operating cash flows on a discretionary basis. The amount of distributions that we may pay to our common stockholders will be determined by our board of directors and is dependent upon a number of factors, including, but not limited to, our financial condition, our capital requirements, our expectations of future sources of liquidity, current and future economic conditions and market demand for timber and timberlands, and tax considerations.

Our primary sources of future capital come from operations of Mahrt Timberland and from proceeds from the Mahrt Credit Facility. The amount of cash available for distribution to stockholders and the level of discretionary distributions declared will depend primarily upon the amount of cash generated from our operating activities, our determination of funding needs for near-term capital and debt service requirements, redemptions of our common

stock, and our expectations of future cash flows.

### Short-Term Liquidity and Capital Resources

Net cash provided by operating activities for the six months ended June 30, 2012 was approximately \$8.8 million, which was primarily comprised of net cash receipts from timber and timberland sales and recreational leases in excess of payments for operating expenses, interest expense, advisor fees and expense reimbursements, forestry management fees, and general and administrative expenses. We intend to use the majority of future cash flows from operating activities, after payments of operating expenses and interest expense, to fund certain capital expenditures and redemptions of our common stock under our SRP.

During the six months ended June 30, 2012, net cash provided by investing activities was approximately \$3.7 million, which was comprised of approximately \$4.2 million released from lender-required escrow accounts, offset by approximately \$0.5 million invested in timber, timberland, and related assets. We expect to utilize the residual cash balance of approximately \$18.3 million as of June 30, 2012 to satisfy current liabilities and fund future timberland acquisitions.

Net cash used in financing activities for the six months ended June 30, 2012 was approximately \$1.1 million. We paid down the Mahrt Loan by approximately \$3.6 million in the second quarter of 2012 with proceeds from timberland sales. During the six months ended June 30, 2012, we accepted proceeds from the sale of common stock under our Follow-On Offering, net of payments of commissions and fees, of approximately \$3.5 million, which sales were agreed to by the investors on or before the effective close date for the primary offering of December 31, 2011. We used \$0.5 million to redeem 356 shares of our preferred stock and related accrued dividends and approximately \$0.5 million to fund redemptions of common stock under our SRP.

We believe that we have access to adequate liquidity and capital resources, including cash flow generated from operations, cash on hand and borrowing capacity, necessary to meet our current and future obligations that become due over the next twelve months.

The Amended Mahrt Loan Agreement contains, among others, the following restrictive and financial covenants:

- requires a fixed-charge coverage ratio of not less than 1.05:1.00 at all times;
- limits our LTV Ratio, to 45%; and
- requires funding of an account under the control of CoBank equal to approximately six months of interest on the Mahrt Debt during any time the LTV Ratio is 30% or greater. Once the LTV Ratio is less than 30%, the required funding will decrease to an amount equal to three months of interest on the Mahrt Debt.

As of June 30, 2012, we believe we were in compliance and expect to remain in compliance with the restrictive and financial covenants of the Amended Mahrt Loan Agreement.

### Long-Term Liquidity and Capital Resources

Over the long-term, we expect our primary sources of capital to include net cash flows from operations, including proceeds from strategic property sales and proceeds from secured or unsecured financings from banks and other lenders. Our principal demands for capital include operating expenses, interest expense on any outstanding indebtedness, certain capital expenditures (other than timberland acquisitions), repayment of debt, timberland acquisitions, redemptions of common and preferred stock, and distributions. We believe that we will be able to refinance any outstanding principal balance of the Mahrt Loan before it becomes due on March 24, 2015.

In determining how and when to allocate cash resources in the future, we will initially consider the source of the cash. We anticipate using a substantial portion of cash generated from operations, after payments of periodic operating

expenses and interest expense, to fund certain capital expenditures required for our timberland. Any remaining cash generated from operations may be used to partially fund timberland acquisitions, redeem common and preferred stock and, finally, pay distributions to stockholders. Therefore, to the extent that cash flows from operations are lower,

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timberland acquisitions and distributions, if any, are anticipated to be lower as well. Lower distributions may reduce the amount of proceeds raised through the DRP, if any, which would limit the number of shares that we may redeem through our SRP. Proceeds generated from future debt financings may be used to fund capital expenditures, to pay down existing and future borrowings, and to redeem preferred stock.

Our charter precludes us from incurring debt in excess of 200% of our net assets. As of June 30, 2012, our debt-to-net-assets ratio, defined as our total debt as a percentage of our total gross assets (other than intangibles) less total liabilities, was approximately 41%. Our debt-to-net-assets ratio will vary based on our level of current and future borrowings, which will depend on the level of net cash flows from operations. As a result, we are not able to anticipate with any degree of certainty what our debt-to-net-assets ratio will be in the near future.

### Contractual Obligations and Commitments

As of June 30, 2012, our contractual obligations are as follows:

| Contractual Obligations                               | Payments Due by Period |             |             |               |             |
|---|------------------------|-------------|-------------|---------------|-------------|
|   | Total                  | 2012        | 2013-2014   | 2015-2016     | Thereafter  |
| Debt obligations                                      | \$118,397,219          | \$—         | \$—         | \$118,397,219 | \$—         |
| Estimated interest on debt obligations <sup>(1)</sup> | 9,564,130              | 2,084,784   | 6,728,675   | 750,671       | —           |
| Operating lease obligations                           | 13,655,041             | 215,515     | 3,117,869   | 2,720,154     | 7,601,503   |
| Due to affiliates                                     | 1,648,503              | 1,648,503   | —           | —             | —           |
| Total   | \$143,264,893          | \$3,948,802 | \$9,846,544 | \$121,868,044 | \$7,601,503 |

Interest obligations are measured at the contractual rate for variable-rate debt, or at the effectively-fixed rate for

<sup>(1)</sup> variable rate debt with interest rate swaps. See Item 3. Quantitative and Qualitative Disclosure About Market Risk for more information regarding our interest rate swap.

### Results of Operations

#### Overview

Our results of operations are materially impacted by the fluctuating nature of timber prices, changes in the levels and composition of our harvest volumes, the level of timberland sales, changes to associated depletion rates, and varying interest expense based on the amount and cost of outstanding borrowings. Timber prices, harvest volumes, and changes in the levels and composition of each for the Mahrt Timberland for the three months and six months ended June 30, 2012 and 2011 is shown in the following table:

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|   | Three Months Ended |             | Change | Six Months Ended |             | Change |
|---|--------------------|-------------|--------|------------------|-------------|--------|
|   | June 30,<br>2012   | 2011        |        | June 30,<br>2012 | 2011        |        |
| Timber sales volume (tons)                      |                    |             |        |                  |             |        |
| Pine pulpwood                                   | 150,706            | 232,482     | (35 )% | 258,661          | 419,731     | (38 )% |
| Pine sawtimber                                  | 21,773             | 32,824      | (34 )% | 60,388           | 72,995      | (17 )% |
| Chip-n-saw                                      | 29,337             | 17,511      | 68 %   | 61,471           | 51,298      | 20 %   |
| Hardwood pulpwood                               | 19,939             | 25,687      | (22 )% | 44,120           | 51,039      | (14 )% |
| Hardwood sawtimber                              | 23,205             | 20,284      | 14 %   | 43,600           | 33,178      | 31 %   |
|   | 244,960            | 328,788     | (25 )% | 468,240          | 628,241     | (25 )% |
| Net timber sales price (per ton) <sup>(1)</sup> |                    |             |        |                  |             |        |
| Pine pulpwood                                   | \$10.62            | \$9.47      | 12 %   | \$10.60          | \$9.81      | 8 %    |
| Pine sawtimber                                  | \$23.04            | \$23.74     | (3 )%  | \$23.19          | \$24.44     | (5 )%  |
| Chip-n-saw                                      | \$16.45            | \$15.86     | 4 %    | \$17.17          | \$17.14     | 0 %    |
| Hardwood pulpwood                               | \$6.78             | \$7.18      | (6 )%  | \$6.59           | \$7.93      | (17 )% |
| Hardwood sawtimber                              | \$20.48            | \$18.75     | 9 %    | \$20.67          | \$19.11     | 8 %    |
| Timberland sales                                |                    |             |        |                  |             |        |
| Gross sales                                     | \$10,552,180       | \$1,021,200 |        | \$10,552,180     | \$1,021,200 |        |
| Sales volumes (acres)                           | 5,802              | 552         |        | 5,802            | 552         |        |
| Sales price (per acre)                          | \$1,819            | \$1,850     |        | \$1,819          | \$1,850     |        |

Prices per ton are shown on a stumpage basis (i.e., net of contract logging and hauling costs) and, as such, the sum<sup>(1)</sup> of these prices multiplied by the tons sold does not equal timber sales in the accompanying consolidated statements of operations for the three months and six months ended June 30, 2012 and 2011.

Comparison of the three months ended June 30, 2011 versus the three months ended June 30, 2012

Revenue. Revenues increased to approximately \$18.3 million for the three months ended June 30, 2012 from approximately \$10.9 million for the three months ended June 30, 2011 due to an increase in timberland sales revenue of approximately \$9.5 million, offset by a decrease in timber sales revenue of approximately \$2.1 million. Timberland sales revenue increased by approximately \$9.5 million due to selling more acres of timberland. Timber sales revenue decreased primarily due to planned reductions in harvest volumes and weaker demand.

Details of timber sales by product for the three months ended June 30, 2012 and 2011 is shown in the following table:

|                             | For the Three<br>Months Ended<br>June 30, 2011 | Changes attributable to: |                | For the Three<br>Months Ended<br>June 30, 2012 |
|-----------------------------|--|--------------------------|----------------|--|
|                             |  | Price                    | Volume         |  |
| Timber sales <sup>(1)</sup> |  |                          |                |  |
| Pine pulpwood               | \$6,148,525                                    | \$107,929                | \$(2,357,165 ) | \$3,899,289                                    |
| Pine sawtimber              | 1,345,228                                      | (22,719 )                | (452,376 )     | 870,133  |
| Chip-n-saw                  | 594,009  | 30,817                   | 323,798        | 948,624  |
| Hardwood pulpwood           | 685,844  | (28,644 )                | (120,949 )     | 536,251  |
| Hardwood sawtimber          | 380,238  | (446 )                   | 428,380        | 808,172  |
|                             | \$9,153,844                                    | \$86,937                 | \$(2,178,312 ) | \$7,062,469                                    |

<sup>(1)</sup> Timber sales are presented on a gross basis.

We expect future quarterly revenue from timber sales related to the Mahrt Timberland to be lower than 2011 based on planned reduction in harvest volumes.





Operating expenses. Contract logging and hauling costs decreased to approximately \$3.8 million for the quarter ended June 30, 2012 from approximately \$5.3 million for the quarter ended June 30, 2011 as a result of a decrease of approximately 26% in delivered wood volume. Depletion expense decreased approximately 13% to approximately \$2.5 million for the three months ended June 30, 2012 from approximately \$2.9 million for the same period in 2011 primarily due to an approximately 25% decrease in total harvest volumes, offset by a higher blended depletion rate. Our blended depletion rate was higher in 2012 due to an increase in harvests on leased tracts as a percentage of our total harvest; timber from leased tracts carries significantly higher depletion rates than timber on fee simple tracts. Cost of timberland sales increased by approximately \$6.9 million due to selling more acres of timberland. Forestry management fees decreased to approximately \$0.6 million for the quarter ended June 30, 2012 from approximately \$0.7 million for the quarter ended June 30, 2011 primarily due to a decrease in incentive fees incurred under the timberland operating agreement with FRC, which are based on net revenue.

Prior to the acquisition of additional timber assets, contract logging and hauling costs and depletion expense are expected to fluctuate with harvest volumes, while forestry management expense, land rent expense, and other operating expenses are expected to remain relatively stable.

Advisor fees and expense reimbursements. Advisor fees and expense reimbursements increased to approximately \$1.6 million for the quarter ended June 30, 2012 from approximately \$0.2 million for the quarter ended June 30, 2011 as a result of an increase in free cash flow primarily due to an increase in revenue from timberland sales. In the second quarter of 2011, advisor fees and expense reimbursements were determined under Advisory Agreement No. 1 and were limited to free cash flow in excess of an amount equal to 1.05 multiplied by interest on outstanding debt. In the second quarter of 2012, advisor fees and expense reimbursements were determined under Advisory Agreement Amendment No. 2 and were limited to one quarter of 1.0% of assets under management. Prior to the acquisition of additional timber assets, advisor fees and expense reimbursements are expected to correlate to the amount of free cash flow in excess of interest on our outstanding debt or our assets under management.

Interest expense. Interest expense decreased to approximately \$1.0 million for the three months ended June 30, 2012 from approximately \$1.4 million for the three months ended June 30, 2011 as a result of a lower principal balance outstanding on our debt facility and a lower weighted-average interest rate. Actual interest expense in future periods will vary based on our level of current and future borrowings, which will depend on the level of cash from operations, the cost of future borrowings, and the opportunity to acquire timber assets fitting our investment objectives.

Interest rate risk instrument. Our loss on an interest rate swap that does not qualify for hedge accounting treatment decreased by approximately \$0.3 million from the three months ended June 30, 2011. The loss was primarily due to the fact that the variable interest rate incurred on the Mahrt Loan was lower than the contractual interest rate of the related interest rate swap during the quarter ended June 30, 2012. The decrease in the loss was primarily due to a decrease in the length of time remaining under the swap contract and changes in the outlook of future market interest rates. We expect future gains and losses on our interest rate swap that does not qualify for hedge account treatment will fluctuate primarily as a result of additional changes in market interest rates and changes in the economic outlook for future market rates.

Net loss. Our net loss decreased to approximately \$0.5 million for the three months ended June 30, 2012 from approximately \$2.3 million for the three months ended June 30, 2011, primarily as a result of an approximately \$1.2 million improvement in operating income, an approximately \$0.4 million decrease in interest expense, and an approximately \$0.3 million decrease in loss on interest rate swap. Our operating income improved due to an increase in net timberland sales revenue of approximately \$2.7 million, offset by an increase in advisor fees and expense reimbursements of approximately \$1.4 million. We sustained a net loss for the three months ended June 30, 2012 primarily as a result of incurring interest expense of approximately \$1.0 million in connection with borrowings used to

finance the purchase of the Mahrt Timberland, offset by an operating income of approximately \$0.5 million. We leveraged the Mahrt Timberland acquisition with substantial short-term and medium-term borrowings as a result of sourcing this acquisition in advance of raising investor proceeds under our Offerings. Our net loss per share available to common stockholders for the three months ended June 30, 2012 and 2011 was \$0.02 and \$0.10, respectively. We

anticipate future net losses to fluctuate with timber prices, harvest volumes, timberland sales, and interest expense based on our level of current and future borrowings.

Comparison of the six months ended June 30, 2011 versus the six months ended June 30, 2012

Revenue. Revenues increased to approximately \$26.2 million for the six months ended June 30, 2012 from approximately \$20.2 million for the six months ended June 30, 2011 due to an increase in timberland sales revenue of approximately \$9.5 million, offset by a decrease in timber sales revenue of approximately \$3.6 million. Timberland sales revenue increased by approximately \$9.5 million due to selling more acres of timberland. Timber sales revenue decreased primarily due to planned reductions in harvest volumes and weaker demand.

Details of timber sales by product for the six months ended June 30, 2012 and 2011 is shown in the following table:

|                             | For the Six<br>Months Ended<br>June 30, 2011 | Changes attributable to: |                | For the Six<br>Months Ended<br>June 30, 2012 |
|-----------------------------|--|--------------------------|----------------|--|
|                             |  | Price                    | Volume         |  |
| Timber sales <sup>(1)</sup> |  |                          |                |  |
| Pine pulpwood               | \$ 10,952,571                                | \$ 132,419               | \$(4,047,162 ) | \$ 7,037,828                                 |
| Pine sawtimber              | 3,017,689                                    | (76,536 )                | (498,570 )     | 2,442,583                                    |
| Chip-n-saw                  | 1,769,034                                    | (12,931 )                | 310,169        | 2,066,272                                    |
| Hardwood pulpwood           | 1,384,762                                    | (54,641 )                | (151,332 )     | 1,178,789                                    |
| Hardwood sawtimber          | 724,222                                      | 121,794                  | 713,208        | 1,559,224                                    |
|                             | \$ 17,848,278                                | \$ 110,105               | \$(3,673,687 ) | \$ 14,284,696                                |

(1) Timber sales are presented on a gross basis.

Future revenue in 2012 from timber sales related to the Mahrt Timberland is expected to be lower than 2011 based on planned reduction in harvest volumes.

Operating expenses. Contract logging and hauling costs decreased to approximately \$7.8 million for the six months ended June 30, 2012 from approximately \$10.0 million for the six months ended June 30, 2011 as a result of an approximately 22% decrease in delivered wood volume. Depletion expense decreased approximately 10% to approximately \$5.5 million for the first six months of 2012 from approximately \$6.1 million for the same period in 2011 primarily due to an approximately 25% decrease in total harvest volumes, offset by a higher blended depletion rate. Our blended depletion rate was higher in 2012 due to an increase in harvests on leased tracts as a percentage of our total harvest; timber from leased tracts carries significantly higher depletion rates than timber on fee simple tracts. Cost of timberland sales increased by approximately \$6.9 million due to selling more acres of timberland. Forestry management fees decreased to approximately \$1.1 million for the first six months in 2012 from approximately \$1.4 million for the same period in 2011 primarily due to a decrease in incentive fees incurred under the timberland operating agreement with FRC, which are based on net revenue. Land rent expense decreased by approximately \$0.1 million primarily due to lease expirations.

Prior to the acquisition of additional timber assets, contract logging and hauling costs and depletion expense are expected to fluctuate with harvest volumes, while forestry management expense, land rent expense, and other operating expenses are expected to remain relatively stable. Cost of timberland sales is directly correlated to the numbers of acres sold.

Advisor fees and expense reimbursements. Advisor fees and expense reimbursements increased to approximately \$2.4 million for the six months ended June 30, 2012 from approximately \$1.8 million for the six months ended June 30, 2011 as a result of using different methodologies to determine the amounts due under the Advisory Agreement and its amendments. In the first quarter of 2011, advisor fees and expense reimbursements of approximately \$1.6 million

were determined under the Advisory Agreement and represented one-quarter of 1.0% of asset management plus actual expense reimbursements. In the second quarter of 2011 and the first quarter of 2012, advisor fees and expense reimbursements were determined under the Advisory Agreement No. 1 and were limited to free cash flow in excess

of an amount equal to 1.05 multiplied by interest on outstanding debt. In the second quarter of 2012, advisor fees and expense reimbursements were determined under Advisory Agreement Amendment No. 2 and were limited to one quarter of 1.0% of assets under management. Prior to the acquisition of additional timber assets, advisor fees and expense reimbursements are expected to correlate to the amount of free cash flow in excess of interest on our outstanding debt or our assets under management.

**General and administrative expenses.** General and administrative expenses decreased to approximately \$1.1 million for the six months ended June 30, 2012 from approximately \$1.2 million for the six months ended June 30, 2011 due to a decrease in legal expense. General and administrative expenses are expected to remain relatively stable in future periods prior to the acquisition of additional timber assets.

**Interest expense.** Interest expense decreased to approximately \$2.0 million for the six months ended June 30, 2012 from approximately \$3.0 million for the six months ended June 30, 2011 as a result of a lower principal balance outstanding on our debt facility and a lower weighted-average interest rate. Actual interest expense in future periods will vary based on our level of current and future borrowings, which will depend on the level of cash from operations, the cost of future borrowings, and the opportunity to acquire timber assets fitting our investment objectives.

**Interest rate risk instrument.** Our loss on an interest rate swap that does not qualify for hedge accounting treatment decreased to approximately \$0.1 million for the six months ended June 30, 2012 from approximately \$0.3 million for the same period in 2011. The loss was primarily due to the fact that the variable interest rate incurred on the Mahrt Loan was lower than the contractual interest rate of the related interest rate swap during the six months ended June 30, 2012. The decrease in the loss was primarily due to a decrease in the length of time remaining under the swap contract and changes in the outlook of future market interest rates. We expect future gains and losses on our interest rate swap that does not qualify for hedge account treatment will fluctuate primarily as a result of additional changes in market interest rates and changes in the economic outlook for future market rates.

**Net loss.** Our net loss decreased to approximately \$3.7 million for the six months ended June 30, 2012 from approximately \$6.8 million for the six months ended June 30, 2011, primarily as a result of an approximately \$1.8 million decrease in operating loss, a decrease in interest expense of approximately \$1.1 million, and a decrease in loss on interest rate swap of approximately \$0.2 million. Our operating loss was lower primarily due to an increase in net timberland sales revenue of approximately \$2.7 million, offset by an increase in advisor fees and expense reimbursements of approximately \$0.5 million. We sustained a net loss for the six months ended June 30, 2012 primarily as a result of incurring an operating loss of approximately \$1.7 million and incurring interest expense and loss on our interest rate swap of approximately \$2.1 million in connection with borrowings used to finance the purchase of the Mahrt Timberland. We leveraged the Mahrt Timberland acquisition with substantial short-term and medium-term borrowings as a result of sourcing this acquisition in advance of raising investor proceeds under our Offerings. Our net loss per share available to common stockholders for the six months ended June 30, 2012 and 2011 was \$0.12 and \$0.30, respectively. We anticipate future net losses to fluctuate with timber prices, harvest volumes, timberland sales, and interest expense based on our level of current and future borrowings.

#### Adjusted EBITDA

The discussion below is presented to enhance the reader's understanding of our liquidity, ability to generate cash, and ability to satisfy lender requirements. Earnings from Continuing Operations before Interest, Taxes, Depletion, and Amortization ("EBITDA") is a non-GAAP measure of our operating performance and cash-generating capacity. EBITDA is defined by the SEC; however, we have excluded certain other expenses due to their noncash nature, and we refer to this measure as Adjusted EBITDA. As such, Adjusted EBITDA, may not be comparable to similarly titled measures reported by other companies. Adjusted EBITDA should not be viewed as an alternative to net income or cash from operations as a measurement of our operating performance, as it excludes certain expenses related to

fixed-asset investments required to generate revenues. Due to our significant amount of debt, management views operating income as the most appropriate earnings measure of our underlying timber operations. Management considers Adjusted EBITDA to be an important measure of our financial condition and cash-generating ability due to the significant amount of fixed assets subject to depletion and the significant amount of financing subject to interest and amortization expense. Our

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credit agreement, as amended, contains a minimum debt service coverage ratio based, in part, on Adjusted EBITDA since the measure is representative of adjusted income available for interest payments.

For the three months ended June 30, 2012, Adjusted EBITDA was approximately \$10.0 million, an approximately \$7.1 million increase from the three months ended June 30, 2011, primarily due to an increase in net revenue from timberland sales, offset by an increase in advisor fees and expense reimbursements and a decrease in net revenue from timber sales. For the six months ended June 30, 2012, Adjusted EBITDA was approximately \$10.9 million, an approximately \$7.5 million increase from the six months ended June 30, 2011, primarily due to an increase in net revenue from timberland sales, offset by a decrease in net revenue from timber sales and an increase in advisor fees and expense reimbursements.

Our reconciliation of net loss to Adjusted EBITDA for the three months and six months ended June 30, 2012 and 2011 follows:

|  | Three Months Ended |                | Six Months Ended |                |
|--|--------------------|----------------|------------------|----------------|
|  | June 30,           |                | June 30,         |                |
|  | 2012               | 2011           | 2012             | 2011           |
| Net loss   | \$(464,306 )       | \$(2,346,944 ) | \$(3,718,373 )   | \$(6,820,870 ) |
| Add:   |                    |                |                  |                |
| Basis of timberland sold   | 6,962,273          | 628,229        | 6,962,273        | 628,229        |
| Unrealized (gain) loss on interest rate swaps that do not qualify for hedge accounting treatment | (256,052 )         | 103,580        | (451,716 )       | (111,434 )     |
| Interest expense <sup>(1)</sup>  | 1,113,884          | 1,499,355      | 2,256,754        | 3,264,397      |
| Depletion  | 2,494,011          | 2,857,962      | 5,474,288        | 6,081,622      |
| Amortization <sup>(1)</sup>  | 185,764            | 166,821        | 370,696          | 330,354        |
| Adjusted EBITDA  | \$10,035,574       | \$2,909,003    | \$10,893,922     | \$3,372,298    |

For the purpose of the above reconciliation, amortization includes amortization of deferred financing costs,

<sup>(1)</sup> amortization of intangible lease assets, and amortization of mainline road costs, which are included in either interest expense, land rent expense, or other operating expenses in the accompanying consolidated statements of operations.

#### Election as a REIT

We have elected to be taxed as a REIT under the Code, and have operated as such beginning with our taxable year ended December 31, 2009. To qualify to be taxed as a REIT, we must meet certain organizational and operational requirements, including a requirement to distribute at least 90% of our adjusted taxable income, as defined in the Code, to our stockholders, computed without regard to the dividends-paid deduction and by excluding our net capital gain. As a REIT, we generally will not be subject to federal income tax on taxable income that we distribute to our stockholders. If we fail to qualify to be taxed as a REIT in any taxable year, we will then be subject to federal income taxes on our taxable income at regular corporate rates and will not be permitted to qualify for treatment as a REIT for federal income tax purposes for that year and for the four years following the year during which qualification is lost, unless the Internal Revenue Service grants us relief under certain statutory provisions. Such an event could materially adversely affect our net income and net cash available for distribution to our stockholders. However, we believe that we are organized and operate in such a manner as to qualify for treatment as a REIT for federal income tax purposes.

#### Inflation

In connection with the acquisition of the Mahrt Timberland, we entered into the Timber Agreements with MeadWestvaco. The Timber Agreements provide that we will sell to MeadWestvaco specified amounts of timber subject to quarterly market pricing adjustments and monthly fuel pricing adjustments, which are intended to protect us



from, and mitigate the risk of, the impact of inflation. The price of timber has generally increased with increases in inflation; however, we have not noticed a significant impact from inflation on our revenues, net sales, or income from continuing operations.

## Application of Critical Accounting Policies

Our accounting policies have been established to conform to GAAP. The preparation of financial statements in conformity with GAAP requires management to use judgment in the application of accounting policies, including making estimates and assumptions. These judgments affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reporting periods. If management's judgment or interpretation of the facts and circumstances relating to various transactions had been different, it is possible that different accounting policies would have been applied or different amounts of assets, liabilities, revenues, and expenses would have been recorded, thus resulting in a different presentation of the financial statements or different amounts reported in the financial statements. Additionally, other companies may utilize different estimates that may impact comparability of our results of operations to those of companies in similar businesses.

A discussion of the accounting policies that management deems critical because they may require complex judgment in their application or otherwise require estimates about matters that are inherently uncertain, is provided below:

### Timber Assets

Timber and timberlands, including logging roads, are stated at cost less accumulated depletion for timber harvested and accumulated amortization. We capitalize timber and timberland purchases and reforestation costs and other costs associated with the planting and growing of timber, such as site preparation; growing or purchases of seedlings; planting; fertilization; herbicide application; and the thinning of tree stands to improve growth. Timber carrying costs, such as real estate taxes; insect control; wildlife control; leases of timberlands; and forestry management personnel salaries and fringe benefits, are expensed as incurred. Costs of major roads are capitalized and amortized over their estimated useful lives. Costs of roads built to access multiple logging sites over numerous years are capitalized and amortized over seven years. Costs of roads built to access a single logging site are expensed as incurred.

### Depletion

Depletion, or costs attributed to timber harvested, is charged against income as trees are harvested. Fee-simple timber tracts owned for longer than one year and similarly managed are pooled together for depletion calculation purposes. Depletion rates are determined at least annually by dividing (a) the sum of (i) net carrying value of the timber, which equals the original cost of the timber less previously recorded depletion, and (ii) capitalized silviculture costs incurred and the projected silviculture costs, net of inflation, to be capitalized over the harvest cycle, by (b) the total timber volume estimated to be available over the harvest cycle. The capitalized silviculture cost is limited to the expenditures that relate to establishing stands of timber. For each fee-simple timber tract owned less than one year, depletion rates are determined by dividing the acquisition cost attributable to its timber by the volume of timber acquired. Depletion rates for lease tracts, which are generally limited to one harvest, are calculated by dividing the acquisition cost attributable to its timber by the volume of timber acquired. Net carrying value of the timber and timberlands is used to compute the gain or loss in connection with timberland sales. No book basis is allocated to the sale of conservation easements.

### Evaluation of the Recoverability of Timber Assets

We continually monitor events and changes in circumstances that could indicate that the carrying amounts of our timber assets may not be recoverable. When indicators of potential impairment are present that suggest that the carrying amounts of timber assets may not be recoverable, we assess the recoverability of these assets by determining whether the carrying value will be recovered through the undiscounted future operating cash flows expected from the

use of the asset and its eventual disposition. Impairment losses would be recognized for (i) long-lived assets used in our operations when the carrying value of such assets exceeds the undiscounted cash flows estimated to be generated from the future operations of those assets, and (ii) long-lived assets held for sale when the carrying value of such assets exceeds an amount equal to their fair value less selling costs. Estimated fair values are calculated based on the following

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information in order of preference, dependent upon availability: (i) recently quoted market prices, (ii) market prices for comparable properties, or (iii) the present value of undiscounted cash flows, including estimated salvage value. We intend to use one harvest cycle for the purpose of evaluating the recoverability of timber and timberlands used in our operations. Future cash flow estimates are based on probability-weighted projections for a range of possible outcomes and are discounted at risk-free rates of interest. We consider assets to be held for sale at the point at which a sale contract is executed and the buyer has made a nonrefundable earnest money deposit against the contracted purchase price. We have determined that there has been no impairment of our long-lived assets to date.

#### Allocation of Purchase Price of Acquired Assets

Upon the acquisition of timberland properties, we allocate the purchase price to tangible assets, consisting of timber and timberland, and identified intangible assets and liabilities, which may include values associated with in-place leases or supply agreements, based in each case on our estimate of their fair values. The fair values of timber and timberland are determined based on available market information and estimated cash flow projections that utilize appropriate discount factors and capitalization rates. Estimates of future cash flows are based on a number of factors including the historical operating results, known and anticipated trends, and market and economic conditions. The values are then allocated to timber and timberland based on our determination of the relative fair value of these assets.

#### Intangible Lease Assets

In-place ground leases with us as the lessee have value associated with effective contractual rental rates that are below market rates. Such values are calculated based on the present value (using a discount rate that reflects the risks associated with the leases acquired) of the difference between (i) the contractual amounts to be paid pursuant to the in-place lease and (ii) our estimate of fair market lease rates for the corresponding in-place lease, measured over a period equal to the remaining terms of the leases. The capitalized below-market in-place lease values are recorded as intangible lease assets and are amortized as adjustments to land rent expense over the weighted-average remaining term of the respective leases.

#### Revenue Recognition

Revenue from the sale of timber is recognized when the following criteria are met: (i) persuasive evidence of an agreement exists, (ii) legal ownership and the risk of loss are transferred to the purchaser, (iii) price and quantity are determinable, and (iv) collectibility is reasonably assured. Our primary sources of revenue are recognized as follows:

- (1) For delivered sales contracts, which include amounts sufficient to cover costs of logging and hauling of timber, revenues are recognized upon delivery to the customer.  
For pay-as-cut contracts, the purchaser acquires the right to harvest specified timber on a tract, at an agreed-upon (2) price per unit. Payments and contract advances are recognized as revenue as the timber is harvested based on the contracted sale rate per unit.  
Revenues from the sale of HBU timberland and nonstrategic timberlands are recognized when title passes and full (3) payment or a minimum down payment is received and full collectibility is assured. If a down payment of less than the minimum down payment is received at closing, we will record revenue based on the installment method.
- (4) For recreational leases, rental income collected in advance is recorded as other liabilities in the accompanying consolidated balance sheets until earned over the term of the respective recreational lease and recognized as other revenue.

In addition to the sources of revenue noted above, we also may enter into lump-sum sale contracts, whereby the purchaser generally pays the purchase price upon execution of the contract. Title to the timber and risk of loss transfers to the buyer at the time the contract is consummated. Revenues are recognized upon receipt of the purchase price. When the contract expires, ownership of the remaining standing timber reverts to us; however, adjustments are

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made to the revenues previously recognized. Any extensions of time will be negotiated under a new or amended contract.

#### Related-Party Transactions and Agreements

We have engaged Wells TIMO and its affiliates to perform certain services under agreements which require us to pay fees and reimbursements to Wells TIMO or its affiliates, including, subject to certain limitations, advisor fees and expense reimbursements, disposition fees, and reimbursements of organization and offering costs. We also previously paid WIS, an affiliate of Wells TIMO, selling commissions and dealer-manager fees in connection with our Public Offerings pursuant to a dealer-manager agreement. See Note 7 to our accompanying consolidated financial statements for a detailed discussion of our related-party agreements and transactions.

#### Assertions of Legal Actions against Related Parties

On March 12, 2007, a stockholder of Piedmont Office Realty Trust, Inc. (“Piedmont REIT”) filed a putative class action and derivative complaint, presently styled In re Wells Real Estate Investment Trust, Inc. Securities Litigation, in the United States District Court for the District of Maryland against, among others, Piedmont REIT; Leo F. Wells, III, our President and Director; Wells Capital, the owner of our advisor; Wells Management Company, Inc. (“Wells Management”); certain affiliates of Wells REF; the directors of Piedmont REIT; and certain individuals who formerly served as officers or directors of Piedmont REIT prior to the closing of an internalization transaction by Piedmont REIT on April 16, 2007.

The complaint alleged, among other things, violations of the federal proxy rules and breaches of fiduciary duty arising from the Piedmont REIT internalization transaction and the related proxy statement filed with the SEC on February 26, 2007, as amended. The complaint sought, among other things, unspecified monetary damages and nullification of the Piedmont REIT internalization transaction.

On June 27, 2007, the plaintiff filed an amended complaint, which attempted to assert class action claims on behalf of those persons who received and were entitled to vote on the Piedmont REIT proxy statement filed with the SEC on February 26, 2007, and derivative claims on behalf of Piedmont REIT.

On March 31, 2008, the Court granted in part the defendants’ motion to dismiss the amended complaint. The Court dismissed five of the seven counts of the amended complaint in their entirety. The Court dismissed the remaining two counts with the exception of allegations regarding the failure to disclose in the Piedmont REIT proxy statement details of certain expressions of interest in acquiring Piedmont REIT. On April 21, 2008, the plaintiff filed a second amended complaint, which alleges violations of the federal proxy rules based upon allegations that the proxy statement to obtain approval for the Piedmont REIT internalization transaction omitted details of certain expressions of interest in acquiring Piedmont REIT. The second amended complaint seeks, among other things, unspecified monetary damages, to nullify and rescind the internalization transaction, and to cancel and rescind any stock issued to the defendants as consideration for the internalization transaction. On May 12, 2008, the defendants answered and raised certain defenses to the second amended complaint. Since the filing of the second amended complaint, the plaintiff has said it intends to seek monetary damages of approximately \$159 million plus prejudgment interest.

On June 23, 2008, the plaintiff filed a motion for class certification. On September 16, 2009, the Court granted the plaintiff’s motion for class certification. On September 20, 2009, the defendants filed a petition for permission to appeal immediately the Court’s order granting the motion for class certification with the Eleventh Circuit Court of Appeals. The petition for permission to appeal was denied on October 30, 2009.

On April 13, 2009, the plaintiff moved for leave to amend the second amended complaint to add additional defendants. The Court denied the plaintiff's motion for leave to amend on June 23, 2009.

On December 4, 2009, the parties filed motions for summary judgment. On August 2, 2010, the Court entered an order denying the defendants' motion for summary judgment and granting, in part, the plaintiff's motion for partial summary

judgment. The Court ruled that the question of whether certain expressions of interest in acquiring Piedmont REIT constituted “material” information required to be disclosed in the proxy statement to obtain approval for the Piedmont REIT internalization transaction raises questions of fact that must be determined at trial.

On November 17, 2011, the Court issued rulings granting several of the plaintiff’s motions in limine to prohibit the defendants from introducing certain evidence, including evidence of the defendants’ reliance on advice from their outside legal and financial advisors, and limiting the defendants’ ability to relate their subjective views, considerations, and observations during the trial of the case. On February 23, 2012, the Court granted several of the defendants’ motions, including a motion for reconsideration regarding a motion the plaintiff had filed seeking exclusion of certain evidence impacting damages, and motions seeking exclusion of certain evidence proposed to be submitted by the plaintiff. The suit has been removed from the Court’s trial calendar pending resolution of a request for interlocutory appellate review of certain legal rulings made by the Court.

On March 20, 2012, the court granted the defendants leave to file a motion for summary judgment. On April 5, 2012, the defendants filed a motion for summary judgment. On April 24, 2012, the plaintiff filed its response to the defendants’ motion for summary judgment. On May 7, 2012, the defendants filed their reply in support of their motion for summary judgment. The defendants’ motion for summary judgment is currently pending before the court.

Mr. Wells, Wells Capital, and Wells Management believe that the allegations contained in the complaint are without merit and intend to vigorously defend this action. Although Wells REF believes that it has meritorious defenses to the claims of liability and damages in these actions, Wells REF is unable at this time to predict the outcome of these actions or reasonably estimate a range of damages, or how any liability and responsibility for damages might be allocated among the 17 defendants in the action, which includes 11 defendants not affiliated with Mr. Wells, Wells Capital, or Wells Management. The ultimate resolution of these matters could have a material adverse impact on Wells REF’ s financial results, financial condition, or liquidity.

#### Commitments and Contingencies

We are subject to certain commitments and contingencies with regard to certain transactions. Refer to Note 1, Note 5, and Note 7 of our accompanying consolidated financial statements for further explanation. Examples of such commitments and contingencies include:

- MeadWestvaco Timber Agreements;
- FRC Timberland Operating Agreement;
- Advisory Agreement, as amended;
- Dealer-Manager Agreement; and
- Structuring Agent Agreement.

#### Subsequent Events

In July 2012, we entered into an agreement to purchase timberland for approximately \$20 million. This transaction is expected to close during the third quarter and will be funded through a combination of cash on hand and debt financing.

On August 6, 2012, our board of directors amended and restated the SRP, referred to as the Amended SRP, effective October 1, 2012. The Amended SRP provides that the redemption price for all redemptions, including redemptions sought within two years of a stockholder’s death, qualifying disability or confinement to a long-term care facility, will be calculated in the same manner. Specifically, until the initial publication in an Exchange Act report filed with the SEC of an estimated per share value approved by the board, the price per share will be 91% of the aggregate amount



paid to us for all shares owned by the redeeming stockholder, divided by the number of shares owned by such stockholder that were acquired from us. After the initial estimated per share value publication, the price will be 95% of the estimated per share value, plus or minus any valuation adjustment as provided in the Amended SRP.

Also on August 6, 2012, our board of directors voted to suspend the Amended SRP effective October 1, 2012 until the first full month following the initial publication of the estimated per share value.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

As a result of entering into the Mahrt Debt, we are exposed to interest rate changes. Our interest rate risk management objectives are to limit the impact of interest rate changes on earnings and cash flows and to lower our overall borrowing costs. To achieve these objectives, we have entered into interest rate swap agreements, and may enter into other interest rate swaps, caps, or other arrangements in order to mitigate our interest rate risk on a related financial instrument. We do not enter into derivative or interest rate transactions for speculative purposes; however, our derivatives do not qualify for hedge accounting treatment. All of our debt was entered into for other than trading purposes. We manage our ratio of fixed- to floating-rate debt with the objective of achieving a mix that we believe is appropriate in light of anticipated changes in interest rates. We closely monitor interest rates and will continue to consider the sources and terms of our borrowing facilities to determine whether we have appropriately guarded ourselves against the risk of increasing interest rates in future periods.

As of June 30, 2012, we had approximately \$118.4 million outstanding on the Mahrt Loan, which matures on March 24, 2015 and bears interest at an adjustable rate based on one-, two-, or three-month LIBOR plus a margin that varies based upon the LTV Ratio at the time of determination. As of June 30, 2012, the weighted-average interest rate of the Mahrt Loan, after consideration of the interest rate swap, was 3.52%.

The terms of the Amended Mahrt Loan Agreement required us to enter into an interest rate protection agreement. As such, we entered into an interest rate swap agreement with Rabobank Group (the “Rabobank Interest Rate Swap”). The Rabobank Interest Rate Swap was effective on September 30, 2010 and matures on March 28, 2013. Under the terms of the Rabobank Interest Rate Swap, we will pay interest at a fixed rate of 2.085% per annum and will receive variable LIBOR-based interest payments from Rabobank Group based the following schedule:

| Start Date         | End Date           | Notional Amount |
|--------------------|--------------------|-----------------|
| June 29, 2012      | September 28, 2012 | \$ 50,000,000   |
| September 28, 2012 | December 31, 2012  | \$ 37,500,000   |
| December 31, 2012  | March 28, 2013     | \$ 28,500,000   |

Approximately \$50.0 million of our total debt outstanding as of June 30, 2012 is subject to a fixed rate when coupled with the interest rate swap. As of June 30, 2012, this balance incurred interest expense at an average rate of 4.585%. A change in the market interest rate impacts the net financial instrument position of our fixed-rate debt portfolio; however, it has no impact on interest incurred or cash flows.

As of June 30, 2012, after consideration of the interest rate swap, approximately \$68.4 million of our total debt outstanding is subject to a variable interest rate. As such, a 1.0% change in interest rates would result in a change in interest expense of approximately \$0.6 million per year. The amount outstanding on our variable-rate debt facility in the future will be largely dependent upon the level of cash from operations and investor proceeds raised under our DRP, if any, and the rate at which we are able to employ such proceeds in the acquisition of timberland properties and toward the repayment of the Mahrt Loan.

### ITEM 4. CONTROLS AND PROCEDURES

Management’s Conclusions Regarding the Effectiveness of Disclosure Controls and Procedures

We carried out an evaluation, under the supervision and with the participation of management, including the Principal Executive Officer and Principal Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) as of the end of the period covered by this quarterly report. Based upon that evaluation, the Principal Executive Officer and Principal Financial Officer concluded that our disclosure

controls and procedures were effective as of the end of the period covered by this quarterly report in providing a reasonable level of assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods in SEC rules and forms, including providing a reasonable level of assurance that information required to be disclosed by us in such reports is accumulated and communicated to our management, including our Principal Executive Officer and our Principal Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

#### Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the quarter ended June 30, 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

From time to time, we are party to legal proceedings, which arise in the ordinary course of our business. We are not currently involved in any legal proceedings of which the outcome is reasonably likely to be material to our business or financial condition, nor are we aware of any such legal proceedings contemplated by governmental authorities.

### ITEM 1A. RISK FACTORS

We are subject to the following additional risks, which are hereby added to the risk factors previously disclosed in our Form 10-K for the year ended December 31, 2011.

If you invest in our shares through an IRA or other retirement plan, you will be limited in your ability to withdraw required minimum distributions.

If you establish an IRA or other retirement plan through which you invest in our shares, federal law may require you to withdraw required minimum distributions (“RMDs”) from such plan in the future. Any share redemptions requested to satisfy these RMD requirements will be considered requests for “ordinary redemptions,” as defined in our share redemption plan. Our share redemption plan limits the amount of ordinary redemptions that can be made in a given year to the lesser of (i) the sum of net proceeds from our distribution reinvestment plan during such period and an additional amounts reserved by our board of directors for such purpose, or (ii) 5% of the weighted-average common shares outstanding during the preceding year. To date we have not paid any cash distributions and therefore, there are no net proceeds from our distribution reinvestment plan, and our board of directors has not reserved any funds for ordinary redemptions. As a result, we have not made any ordinary redemptions and it is not likely that you will be able to redeem your shares at a time in which you need liquidity to satisfy the RMD requirements under your IRA or other retirement plan. Even if we begin paying cash distributions and receive net proceeds from our distribution reinvestment plan, it is likely that you will not be able to redeem all of your shares at one time, and any share that you redeem will be at a price less than the price at which the shares were initially purchased. If you fail to withdraw RMDs from your IRA or other retirement plan, you may be subject to certain tax penalties.

Stockholders may not be able to sell their shares under the SRP and, if they are able to sell their shares under the plan, they may not be able to recover the amount of their investments in our shares.

Our board of directors has adopted an SRP, as amended; however, the Amended SRP will be suspended effective October 1, 2012 until the first full month following our publication of an estimated per share value approved by our board of directors. During that suspension, no redemptions, including those for death, disability or confinement to a long-term care facility, will be permitted.

Prior to our Amended SRP's suspension and following its reinstatement, there are significant conditions and limitations that would limit stockholders' ability to sell their shares under the plan. The Amended SRP limits the number of shares that may be redeemed in any calendar year to the lesser of (i) the sum of net proceeds from our distribution reinvestment plan during such period and any additional amounts reserved by our board of directors for such purposes and (ii) in the case of ordinary redemptions only, 5% of the weighted-average number of shares outstanding during the prior calendar year. In addition, our board of directors may amend, further suspend, or terminate our Amended SRP upon 30 days' notice and without stockholder approval.

We have not yet paid any cash distributions and, therefore, have not received any proceeds under our distribution reinvestment plan and have not made any ordinary redemptions. In addition, our board of directors has not reserved any amounts except for redemptions made in connection with death, qualifying disability, or confinement to a

long-term care facility, which amount is limited to \$150,000 per month.

Effective October 1, 2012, until the initial publication in an Exchange Act report filed with the SEC of an estimated per share value approved by our board of directors, the price per share for all redemptions will be 91% of the aggregate

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amount paid to us for all shares owned by the redeeming stockholder, divided by the number of shares owned by such stockholder that were acquired from us. After the initial estimated per share value publication, the price will be 95% of the estimated per share value, plus or minus any valuation adjustment as provided in the Amended SRP.

Even if we begin paying cash distributions and receive net proceeds from our distribution reinvestment plan, it is likely that you will not be able to redeem all of your shares at one time, and any share that you redeem may be at a price less than the price at which the shares were initially purchased.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(a) Not applicable.

(b) Not applicable.

(c) During the quarter ended June 30, 2012, we redeemed shares as follows:

| Period     | Total Number of Shares Redeemed | Average Price Paid per Share | Total Number of Shares Purchased as Part of a Publicly Announced Plan or Program | Approximate Dollar Value of Shares Available That May Yet Be Redeemed Under the Program |
|------------|---------------------------------|------------------------------|--|---|
| April 2012 | 6,596                           | \$ 9.54                      | 6,596  | (1)   |
| May 2012   | 13,181                          | \$ 9.58                      | 13,181   | (1)   |
| June 2012  | 3,144                           | \$ 9.54                      | 3,144  | (1)   |

Our share redemption plan commenced on August 11, 2006 and was amended on November 8, 2010, March 16, 2012, and August 6, 2012. Our board of directors is suspending our Amended SRP effective October 1, 2012 until the first full month following the publication in an Exchange Act report filed with the SEC of the estimated per share value approved by our board of directors. Our share redemption plan, as amended, limits redemptions of our common stock as follows: the shares redeemed under the share redemption plan cannot exceed the lesser of (i) the amount redeemable from the sum of net proceeds from the sale of shares through the distribution reinvestment plan plus any additional amounts reserved for redemptions by our board of directors, or (ii) in any calendar year, 5% of the weighted-average common shares outstanding during the preceding year. The terms of the Mahrt Debt prohibit us from making redemptions, other than upon the death or qualifying disability of a stockholder, during any period in which the LTV ratio exceeds 40% (see Note 4 of the accompanying consolidated financial statements). Redemptions sought within two years of the death or qualifying disability of a stockholder do not require a one-year holding period and are subject only to the overall limitation that during any calendar year, aggregate redemptions may not exceed 100% of the net proceeds from our distribution reinvestment plan during the calendar year and any additional amounts reserved for such purpose by our board of directors. Our board of directors may amend, suspend, or terminate the share redemption plan upon 30 days notice. Our board of directors has approved a monthly, noncumulative reserve of \$150,000 funded with operating cash flows for death or qualifying disability redemptions of common stock. As of June 30, 2012, all qualified shares tendered for redemption had been redeemed.

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES

(a) There have been no defaults with respect to any of our indebtedness.

(b) Not applicable.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

(a) During the second quarter of 2012, there was no information that was required to be disclosed in a report on Form 8-K that was not disclosed in a report on Form 8-K.

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### Submission of Matters to a Vote of Security Holders

On August 6, 2012, we held our annual meeting of stockholders for the purpose of electing the following individuals to our board of directors: E. Nelson Mills, Donald S. Moss, Willis J. Potts, Jr., George W. Sands, and Leo F. Wells, III.

All of the director nominees were elected to serve as directors until the next annual meeting of the stockholders and until their successors are duly elected and qualified. The number of votes cast for and votes withheld for each of the director nominees were as follows:

| Name                 | Votes For  | Votes Withheld |
|----------------------|------------|----------------|
| E. Nelson Mills      | 15,448,390 | 606,722        |
| Donald S. Moss       | 15,433,660 | 621,452        |
| Willis J. Potts, Jr. | 15,458,309 | 596,804        |
| George W. Sands      | 15,432,874 | 622,239        |
| Leo F. Wells, III    | 15,436,115 | 618,997        |

### Amendment and Suspension of Share Redemption Plan

On August 6, 2012, our board of directors amended and restated the SRP, or the Amended SRP, effective October 1, 2012. The Amended SRP provides that the redemption price for all redemptions, including redemptions sought within two years of a stockholder's death, qualifying disability or confinement to a long-term care facility, will be calculated in the same manner. Specifically, until the initial publication in an Exchange Act report filed with the SEC of an estimated per share value approved by the board, the price per share will be 91% of the aggregate amount paid to us for all shares owned by the redeeming stockholder, divided by the number of shares owned by such stockholder that were acquired from us. After the initial estimated per share value publication, the price will be 95% of the estimated per share value, plus or minus any valuation adjustment as provided in the Amended SRP.

Also on August 6, 2012, our board of directors voted to suspend the Amended SRP effective October 1, 2012 until the first full month following the initial publication of the estimated per share value.

Under the terms of the current SRP, we redeem shares on the last business day of each month (the "Redemption Date"). For an eligible stockholder's shares to be redeemed on the Redemption Date, we must receive a written redemption request at least five business days before the Redemption Date. As a result, all written redemption requests to be redeemed under the terms of the current SRP for September 2012 must be properly received us not later than September 21, 2012. Any redemption requests received subsequent to September 21, 2012 will be redeemed under the terms of the Amended SRP following its reinstatement unless the request is earlier withdrawn by the redeeming stockholder.

(b) There are no material changes to the procedures by which stockholders may recommend nominees to our board of directors since the filing of our Schedule 14A.

### ITEM 6. EXHIBITS

The exhibits required to be filed with this report are set forth on the Exhibit Index hereto and incorporated by reference herein.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

WELLS TIMBERLAND REIT, INC.

(Registrant)

Date: August 6, 2012

By: /s/ DOUGLAS P. WILLIAMS

Douglas P. Williams

Executive Vice President, Secretary, Treasurer and

Principal Financial Officer

EXHIBIT INDEX TO  
SECOND QUARTER 2012 FORM 10-Q OF  
WELLS TIMBERLAND REIT, INC.

| Exhibit Number | Description  |
|----------------|--|
| 3.1            | Fifth Articles of Amendment and Restatement (incorporated by reference to Exhibit 3.1 to the Quarterly Report on Form 10-Q for the quarter ended June 30, 2010 filed on August 12, 2010 (the "2010 Second Quarter Form 10-Q"))                             |
| 3.2            | Articles of Amendment to the Fifth Articles of Amendment and Restatement (incorporated by reference to Exhibit 3.2 to the Quarterly Report on Form 10-Q for the quarter ended June 30, 2011 filed on August 9, 2011 (the "2011 Second Quarter Form 10-Q")) |
| 3.3            | Third Amended and Restated Bylaws (incorporated by reference to Exhibit 3.2 to the 2010 Second Quarter Form 10-Q)  |
| 3.4            | First Amendment to Third Amended and Restated Bylaws (incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K filed on October 12, 2010)  |
| 4.1*           | Third Amended and Restated Share Redemption Plan   |
| 31.1*          | Certification of the Principal Executive Officer of the Company, pursuant to Securities Exchange Act Rule 13a-14 and 15d-14 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002   |
| 31.2*          | Certification of the Principal Financial Officer of the Company, pursuant to Securities Exchange Act Rules 13a-14 and 15d-14 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002  |
| 32.1*          | Statement of the Principal Executive Officer and Principal Financial Officer of the Company, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002   |
| 101.INS**      | XBRL Instance Document   |
| 101.SCH**      | XBRL Taxonomy Extension Schema Document  |
| 101.CAL**      | XBRL Taxonomy Extension Calculation Linkbase Document  |
| 101.DEF**      | XBRL Taxonomy Extension Definition Linkbase Document   |
| 101.LAB**      | XBRL Taxonomy Extension Label Linkbase Document  |
| 101.PRE**      | XBRL Taxonomy Extension Presentation Linkbase Document   |

\* Filed herewith

Furnished with this Form 10-Q. Pursuant to Regulation S-T, this interactive data file is deemed not filed or part of a \*\*registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act, is deemed not filed for purposes of Section 18 of the Exchange Act, and otherwise is not subject to liability under these sections.

