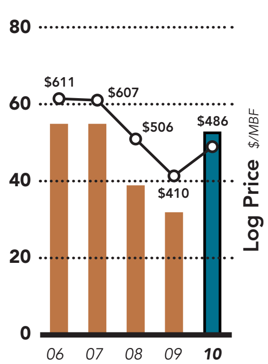
pope resources | 2010 annual report

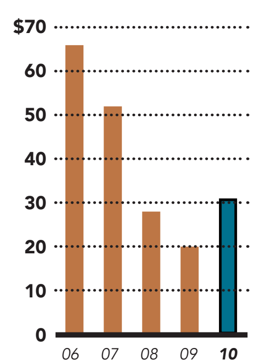
financial highlights

(thousands, except per unit data)	**2010**	2009	2008
Revenue			
Fee Timber	**$27,674**	$14,847	$23,551
Timberland Management & Consulting	**31**	601	944
Real Estate	**3,487**	5,030	3,683
Total revenue	**$31,192**	$20,478	$28,178
Income/(loss) from operations			
Fee Timber	**$9,703**	$3,724	$6,294
Timberland Management & Consulting	**(1,250)**	(375)	(543)
Real Estate	**(809)**	1,663	(1,111)
Administrative	**(4,731)**	(3,733)	(3,951)
Total income from operations	**$2,913**	$1,279	$689
Net income	**$2,038**	($272)	$1,162
Net income per fully diluted unit	**$0.43**	($0.07)	$0.23
Net cash provided by operating activities	**$8,950**	$662	$3,952
Free cash flow	**$4,894**	($1,615)	$1,957
Free cash flow per fully diluted unit	**$1.07**	($0.36)	$0.42
Unit price at year-end	**$36.80**	$24.60	$20.00
Distribution per unit	**$0.70**	$0.70	$1.60
Units outstanding at year-end per Nasdaq	**4,328**	4,576	4,665
Total assets	**$235,837**	$187,056	$165,411
Long-term debt, including current portion	**50,498**	29,490	29,586
Noncontrolling interests	**107,817**	70,931	44,354
Partners' capital	**70,990**	83,126	87,817
Partners' capital per unit	**$16.40**	$18.17	$18.83
Fee timber harvest (MMBF)	**53**	32	38

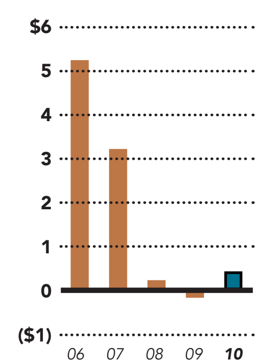
Harvest Volume
MMBF



Total Revenue
millions



Earnings Per Diluted Unit



David L. Nunes
President and
Chief Executive Officer

dear fellow unitholders

At the risk of sounding overly optimistic, the world feels quite different than it did a year ago. While the U.S. housing market remains mired in structural challenges associated with high unemployment, a growing inventory of foreclosed properties, and continued lending constraints, the cover photo speaks loudly to a significant driver in an improved log market outlook. A year ago, we were coming off of an extraordinarily challenging year with a 20-year low in company revenue and failure to generate a profit for only the third time in our company's history. Looking forward from that year-ago vantage point, we anticipated that 2010 looked at best marginally better than the prior year as our national economy seemed to have hit the recession's bottom. We adopted a cautious operating posture for 2010 and planned to harvest 32 million board feet (MMBF) of logs in 2010, a level similar to 2009 and well below what we could sustainably harvest.

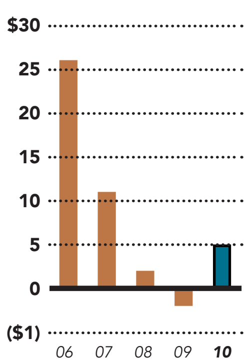
Largely on the strength of a resurgent demand from China for both logs and lumber, which I will speak to in more detail in this letter, we were able to relax a portion of our self-imposed harvest deferral and sell 53 MMBF of logs during the year. In concert with a $2.4 million conservation easement sale, this uptick in demand allowed us to enjoy better-than-expected 2010 results. Our revenue climbed to $31 million and our net income attributable to unitholders was $2.0 million, or $0.43 per diluted ownership unit. While well below our pre-recession performance levels, these results nevertheless represented a meaningful improvement over the prior two years.

Just as we are encouraged by our improved financial performance in 2010, we are even more excited about some of the accomplishments of this past year that will bear fruit down the road. These include placement of the final $58 million of capital from our second timber fund, preliminary plat approval for 824 residential lots at our Gig Harbor project, and completion of our long-term debt restructuring. I will touch on each of these important milestones in more detail below. I will also discuss the surge in demand for wood products from China, our projected future harvest levels, our focus on pursuing conservation easements during the current real estate downturn, various capital allocation decisions, and a new incentive compensation system adopted this past year.

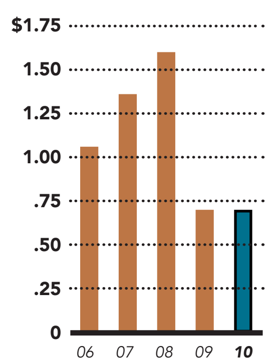
Timber Fund Business Completes Placement of Fund II Capital

In early 2009, we completed the final closing of ORM Timber Fund II (Fund II), an $84 million private equity fund specializing in direct timberland investments in the Pacific Northwest. As with our first timber fund, Pope Resources has a 20%

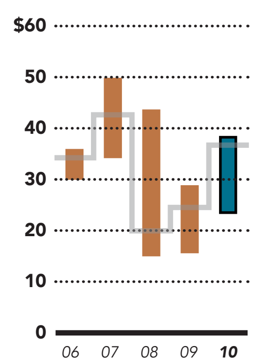
Free Cash Flow
millions



Distribution Per Unit



Unit Trading Range
close



(opposite)

Our 251-acre Harbor Hill project is located in Gig Harbor, a 20-minute drive from downtown Tacoma, Washington's third-largest city. As depicted on the facing page, Harbor Hill has the following components: 200 acres of land zoned for 554 single-family lots and 270 multi-family units, a 16-acre retail site, and 35 acres of business park lots.

co-investment stake in Fund II. As challenging as it was to raise this fund during the depths of the financial crisis, it has been equally exciting to have committed capital at our disposal over the past few years.

With log and lumber markets in distress as a result of depressed housing starts over the past few years, we noted three important changes to timberland markets. First, more lands were being put up for sale as companies were liquidating timberland holdings to help them weather the economic downturn. In these offerings, we also saw a heavier mix of properties with merchantable timber, as many companies were opting to sell such lands rather than harvesting into a soft log market. Finally, we saw the emergence of more negotiated sale opportunities as many potential sellers were reluctant to have failed auctions become public knowledge. With Fund II's committed capital ready to be deployed, we were in a position to participate in many of these privately negotiated sales. Starting in 2008, when we began placing bids on properties for Fund II, through the second half of 2010, we submitted 20 bids on timberland properties that totaled 160,000 acres valued at $316 million. Our bids averaged 25% below the successful transaction price for those properties that actually sold, underscoring our disciplined approach to property due diligence and valuation.

We were ultimately successful in buying four tree farms totaling 37,000 acres, with two closings in the fourth quarter of 2009 and two more in the third quarter of 2010. Three of these tree farms are located in northwest Oregon and one in southwest Washington. Our success in landing these properties was due in no small part to our outreach program toward potential sellers. Collectively, we bought these properties for $92 million, with an average purchase price of $2,486 per acre. Fund II has an $11 million timber mortgage, which translates to a modest 12% loan to value ratio. This mortgage is interest-only for the 10-year term of the loan and carries an interest rate of 4.85%, which we believe provides us with ample operating flexibility going forward.

These Fund II properties on average are older than our other tree farms, with 45% of the productive acres aged 35 and older. These older age classes are heavily stocked with 270 MMBF of merchantable timber and, depending on the recovery in log market demand over the next few years, are expected to add between 20 MMBF and 30 MMBF of annual harvest volume over the next decade. When we acquired the first two properties for Fund II in 2009, our underwriting assumptions did not call for the harvest of any volume until 2012, but 2010's stronger-than-expected market recovery allowed us to begin harvesting well ahead of schedule. This in turn facilitated cash distributions to investors of 1.3% and 3.0% of total paid-in capital in the fourth quarter of 2010 and first quarter of 2011, respectively.

We are excited to have this Fund II capital placed and look forward to adding value to these assets. We believe these tree farms will make solid contributions to our cash flow generation over the next decade, for both our outside investors and Pope Resources. We are busy working on our next timber fund offering and hope to close it during 2011.

Gig Harbor Preliminary Plat Approval and Long-term Development Agreement

We have described in prior versions of this letter the ongoing entitlement efforts related to our 251-acre mixed use development project in Gig Harbor, Washington, a suburb of Tacoma. This project, which we refer to as Harbor Hill, is the most valuable asset within our Real Estate portfolio. In addition to 200 acres of land zoned for multi- and single-family residential development, it contains a 16-acre retail site and 35 acres of business park lots.

In late 2008, we submitted a preliminary plat application for the 200-acre residential portion of Harbor Hill. Since that time, we have worked with the City of Gig Harbor to complete this important entitlement. In December 2010 we entered


HARBOR HILL
M1
Multi-Family
Residential
9.48 acres
Borgen Boulevard
M2
Multi-Family
Residential
9.77 acres
LOT 6
PCD-C
16.06 acres
Costco
LOT 1A
6.40 acres
LOT 5
PCD-BP
11.30 acres
LOT 1B
5.07 acres
HARBOR HILL DRIVE
LOT 4B
PCD-BP
5.37 acres
LOT 4A
PCD-BP
6.15 acres
West Storm
Pond
YMCA
Burnham Drive
Ball fields
LOT 3
PCD-BP
7.07 acres
DNR Swede Hill
(McCormicks Forest)
Cushman Trail Extension (Future)
Peacock Hill Ave. NW
Future Connection
Burnham Dr.
Cushman Trail (Existing)
Legend
40 ft wide lots – 79 total
50 ft wide lots – 172 total
60 ft wide lots – 114 total
70 ft wide lots – 189 total
N

into a 20-year development agreement with the City of Gig Harbor, which formed the foundation for the subsequent preliminary plat approval received in January 2011. The preliminary plat approval allows for the development of 554 single-family lots and 270 multi-family units on this project. The development agreement protects the preliminary plat approval for a period of 20 years and also reserves on behalf of the project's 824 residential units a sufficient capacity for needed domestic water supply, sanitary sewer, and traffic trips. Additionally, in exchange for the dedication of a seven-acre parcel of land for City park purposes, park impact fees will be waived for all residential units.

The development agreement and subsequent preliminary plat approval are significant milestones for the Harbor Hill project. Our strategy on this project has been to bring amenities to the residential portion of the project ahead of the actual sales of residential lots. This has included the sale and subsequent construction of a regional YMCA as well as a Costco Wholesale store and neighboring retail pads. These sales, in addition to bringing needed amenities to the project, have paid for significant infrastructure investments that will also benefit the remaining commercial, business park, and residential portions of the project. We also believe this strategy will help Harbor Hill compete favorably against other large residential projects in Puget Sound, as evidenced by the strong interest we've seen from a number of merchant homebuilders and apartment building developers all through the recent economic downturn. With the key residential entitlements now completed, we hope to be able to begin residential sales within the next few years from this project.

Completion of Long-term Debt Restructuring

In 2010, we completed the second phase of a restructuring of all of our long-term debt, an important goal we set for ourselves during the recession. We had two timber mortgages set to mature in April 2011. As each mortgage had an expensive make-whole premium, we needed to complete this debt restructuring toward the end of their respective loan terms. In 2009, we refinanced a $9.8 million timber mortgage and in 2010 we refinanced another $20 million timber mortgage. These new mortgages include financed make-whole premiums related to early extinguishment of the prior mortgages of $1.1 million and $1.2 million, respectively, in 2009 and 2010. Together, these refinancings represent a substantial trading down of our weighted average interest rate from 8.2% in mid-2009 to 5.6% at present and a correspondingly significant annual savings in interest expense. In addition, we have also laddered our debt maturities so that we do not have the same sort of concentrated refinancing risk at any single point in time in the future. Our maturities are a mix of four, six, eight, and 14 years from now, with greater flexibility to pay them down earlier than was the case with our former timber mortgages. Finally, the new timber mortgages are interest-only in their debt service, thus preserving cash and providing for greater operating flexibility going forward. While this debt restructuring was a drag on earnings in both 2009 and 2010 because of the make-whole premiums, they did not affect cash flow due to rolling each into replacement financings. We are very pleased to have this new debt structure in place.

Surge in Demand from China

Much has been written recently concerning the rising volumes of both log and lumber exports to China from the U.S. Pacific Northwest and British Columbia. The impetus behind much of this increased flow of logs and lumber was a 2007 log export tariff of 25% imposed by Russia. This export tariff was put in place to encourage investment in forest products manufacturing capacity and job growth in Russia. In response to this tariff, manufacturing capacity in China shifted away from the Sino-Russian border and more to China's coastal regions, which resulted in large disruptions to log flows throughout Asia over the past few years.

Early beneficiaries of this shift in log exports to China were timberland owners in New Zealand, which had been primarily supplying logs to Korea. With surging demand from China, producers in New Zealand increased overall export volumes with a correspondingly significant market share shift from Korea to China. Log buyers in Korea, in turn, shifted to other markets for their supply. The U.S. Pacific Northwest experienced a significant increase in log exports to Korea in 2008 as a result of these market dynamics. Beginning in 2009, logs started flowing from the U.S. Pacific Northwest to China for the first time in a number of years.

With Chinese GDP growth of 10% in 2010, the volume of softwood log imports increased by 20% over 2009. However, log imports from Russia, its largest supplier, actually decreased by 5% and their market share declined from 73% to 58%. With a surging Chinese economy and weak U.S. housing starts, significant log flows were diverted to China from the U.S. Pacific Northwest and British Columbia. The U.S. Pacific Northwest saw its market share of Chinese softwood log imports jump from 4% to 12%, while British Columbia increased its market share from 2% to 7%.

Unlike Japan, China uses much of its log and lumber imports for lower valued uses such as concrete forms and wood pallets. They also have fairly large furniture and flooring industries, but do not use as much wood for building homes as we are accustomed to seeing in North America. As such, China competes for lower quality logs and lumber compared to Japan and is buying wood that would otherwise ultimately flow to the U.S. housing market. So China's imports of logs and lumber represent an important relief valve for U.S. timberland owners and forest products manufacturers who have suffered from reduced demand associated with anemic U.S. housing starts.

Most log exports from the U.S. Pacific Northwest are shipped in breakbulk form, where the logs are loaded directly into a ship's hold and onto its top deck, as opposed to containerized shipments. Breakbulk volumes from Washington and Oregon to China increased nearly nine-fold, from 41 MMBF in 2009 to 351 MMBF in 2010, a level not seen since the early 1990s. In addition, breakbulk volumes to Korea nearly tripled, increasing from 22 MMBF in 2009 to 60 MMBF in 2010. While Japan remained the largest export log market in 2010, volume growth to Japan was relatively flat with volumes up by a modest 4%, from 379 MMBF in 2009 to 392 MMBF in 2010. Overall breakbulk export log volumes from Washington and Oregon to Asia nearly doubled in 2010, increasing from 442 MMBF in 2009 to 804 MMBF in 2010. This represents the highest level of log exports since 2000. As a result of this volume increase and the opening up of the Chinese market, logs were exported from two U.S. ports that had not shipped export logs since 2000 and a third port that had not shipped export logs since 2005. The cover photo of this annual report depicts a breakbulk shipment of logs being loaded for delivery to Korea out of one of these ports in Astoria, Oregon.

British Columbia experienced an even stronger growth rate in its log export shipments. Overall breakbulk export log volumes to Asia increased 152%, from 235 MMBF in 2009 to 591 MMBF in 2010. Export log volumes to China increased from just 14 MMBF in 2009 to 181 MMBF in 2010, while exports to Korea nearly tripled, from 53 MMBF in 2009 to 132 MMBF in 2010. Finally, export volumes to Japan increased 66%, from 168 MMBF in 2009 to 278 MMBF in 2010.

Just as important as the increasing log flows to China was the emergence of significant volumes of lumber imports by China. Its softwood lumber imports increased 49% in 2010 based on both the strong GDP growth and the decline in Russian log imports. While Russia remains the largest supplier of lumber to China with a 30% market share, and increased their lumber shipments by 40% in 2010, their market share declined slightly from 2009. Canada, led by British Columbia, increased its share of the Chinese softwood lumber import market to 27% as exports grew by 76%. Much of this Canadian lumber export volume, estimated at 2.85 billion board feet, was a byproduct of harvesting dead and dying timber impacted by the mountain pine beetle epidemic. This allowed producers in British Columbia to utilize manufacturing capacity that would otherwise have remained idled as a result of the low level of U.S. housing starts. As these trends continue, Canada is expected by many to surpass Russia as the largest supplier of export lumber to China in 2011.

In 2010, the U.S. saw a 54% increase in lumber exports to China, estimated at nearly one billion board feet. The growth in U.S. lumber exports to China was an important development for us as many of our sawmill customers began shipping significant volumes of lumber to China. This in turn allowed them to pay more for logs and compete directly with brokers shipping logs to China. We would not have seen the same degree of log price appreciation in 2010, especially in light of anemic U.S. housing starts, were it not for the fact that we experienced increases in both log and lumber shipments to China from the U.S. Pacific Northwest.

As we look at 2011, we expect many of these trends to continue, and are optimistic regarding their impact on log and lumber markets generally and on our company specifically. China's economy is continuing to grow and analysts believe China is only able to supply approximately 60% of its wood products needs internally. China will continue to be heavily dependent on log and lumber imports and we see many of the changes in the supply dynamics as structural, not temporary shifts, all of which bodes well for log and lumber exports from the U.S. Pacific Northwest and British Columbia. We are fortunate in that 90% of our Fee Timber holdings are directly tributary to ports that are active in the existing log export trade, so we expect to continue to benefit from this increased export log demand.

Harvest Level Going Forward

In response to positive market dynamics, we ended up harvesting 53 MMBF in 2010, 42 MMBF from the company's owned lands and the remaining 11 MMBF from our timber funds' tree farms. While this represents a significant increase from the 32 MMBF harvested in 2009, it is still well below our sustainable harvest level of 70 MMBF. With harvest deferrals that began in 2008, we ended 2010 with a cumulative harvest deferral of 50

MMBF, with 27 MMBF from the company's owned lands and 23 MMBF from our timber fund properties. This harvest deferral represents 71% of our annual sustainable harvest level of 70 MMBF.

Given strong log market conditions entering 2011, we expect to harvest more volume in 2011 than last year, but have not yet determined the extent of the increase. With U.S. housing starts still limping along at historically low levels, we recognize that our harvest posture will have to remain flexible going forward. Right now our optimism with regard to 2011 harvest levels is based on expectations of continued strength in export log demand, particularly from China, coupled with the indirect impact of increased lumber exports to China.

With the recent tragic earthquake and tsunami in Japan, we anticipate a positive longer term impact to the Japanese log export market, but expect this may take some time to commence. There will likely be some short-term reductions in shipments to Japan as that country struggles to get power grids back on line, port infrastructure up and running, and damaged wood products manufacturing capacity repaired.

From an operational perspective, we will work hard to remain nimble going forward, which means a continued emphasis on obtaining permits for harvest units well ahead of time. This will provide us with the flexibility to capitalize on changing market conditions by switching out different harvest units to take advantage of pricing differentials among different species or regional markets.

If log markets continue to gradually improve, we expect to discontinue any further harvest deferrals and begin to chip away at our 50 MMBF of harvest deferral volume. We expect that this incremental harvest volume will be metered in over a three- to five-year period provided log markets continue to improve. Harvest levels from the timber funds will likely see a disproportionate amount of this increase based on both deferrals and the fact that some of these acquired tree farms contain a disproportionately large number of acres stocked with currently merchantable timber.

Pursuit of Conservation Easement Sales During Real Estate Downturn

The market for land remains in an extremely depressed state with many transactions in raw and developed lots coming from bank foreclosures. Notwithstanding the grim market for land that we are currently experiencing, our focus remains on adding value through attaining entitlements for our various real estate projects. The entitlement process represents a long-term investment that looks through the ups and downs of the business cycle. Once the market begins to absorb the current glut of foreclosed properties and employment levels and bank lending improve, we believe markets for raw land will improve as well. We continue to believe there will be a shortage of permitted lots at that juncture and are preparing to meet that anticipated demand. Our master planned developments in Gig Harbor and Kingston, which now have a combined preliminary plat approval on 1,575 residential lots, are prime examples of efforts focused on the downstream recovery in local real estate markets.

As an important alternative to residential land sales, we have had success over the past decade pursuing conservation-related sales that preserve lands for recreational, wildlife management, watershed protection, or other public benefits. Conservation sales take the form of either granting an easement where we forego future development opportunities in order to preserve working forests, or the outright sale of the property in fee simple terms. When we grant a conservation easement, we nearly always retain the right to harvest timber and otherwise continue to operate the newly encumbered properties as industrial timberlands. Since 2004, we have realized $14.6 million on conservation related sales. Over this time frame, we closed on $5.7 million of fee simple conservation sales that totaled nearly 1,400 acres, at an average price of $4,085 per acre. The remaining $9.0 million in sales, all since 2008, were for conservation easements encumbering 17,300 acres at an average price of $517 per acre.

In 2010, we closed on a $2.4 million conservation easement sale on nearly 6,900 acres south of the Swift Reservoir in southwest Washington. The easement, funded by the federal Forest Legacy program, will restrict future development on the property while allowing for the continued growth and harvest of timber. This conservation easement sale represented the culmination of several years of coordinated effort with Skamania County, the Columbia Land Trust, and the Washington State Department of Natural Resources. Several years ago the parties to this sale began working together on a joint vision for a 24,000-acre subset of our Columbia tree farm near the Swift Reservoir. This joint vision calls for putting a total of 20,000 acres into various conservation programs, while allowing for development on the remaining 4,000 acres. The parties have applied for a number of federal grants with the intent of additional closings in the years ahead.

Our success in securing funding for conservation easement sales is based on a number of factors, including having properties adjacent to public lands where the threat to development is a concern among a number of stakeholders. We have also worked hard to develop relationships with key individuals in local government, conservation organizations, and funding agencies. We recognize that funding for conservation transactions is in jeopardy based on economic conditions and further recognize that more parties than ever are competing for the limited supply of conservation funding. So while we may have enjoyed success in this arena, we recognize there are no guarantees going forward.

Capital Allocation

In connection with Fund II's 2010 timberland acquisitions, which totaled more than 25,000 acres, Pope Resources contributed a total of $9.7 million of co-investment capital. In concert with the $7.0 million of co-investment capital contributed in 2009 for Fund II's purchase of two tree farms in Oregon, our total co-investment for Fund II stands at $16.7 million of contributed capital, or 20% of the total contributed capital. The drawdown period ended for Fund II in March 2011 with 99% of the committed capital placed in four separate transactions. We are excited about the addition of these lands, which total 37,000 acres and include 270 MMBF of merchantable timber inventory (35+ years old). We expect these lands to contribute meaningful harvest and cash flow over the next decade as we capitalize on what are expected to be improving market conditions.

After undertaking significant harvest deferrals beginning in 2008, we cut our quarterly distribution by a total of 75% during 2009, from $0.40 per quarter at the end of 2008 to $0.10 per quarter at the end of 2009. We intentionally erred on the side of being conservative given the uncertainty surrounding the duration of the recession and our desire to conserve cash rather than being put in a position of having to either sell land or increase harvest volumes to meet our quarterly distribution. As we began to relax our harvest deferrals in mid-2010 in response to the increased demand from China, we had more confidence in our future cash flow generation and, as such, increased our quarterly distribution 150% to $0.25 beginning in the third quarter of 2010.

In 2010, we started using a new metric, adjusted cash available for distribution (ACAD), in our internal discussions regarding our quarterly distribution level. We define ACAD as cash flow from operations plus financed debt extinguishment costs, less maintenance capital expenditures and required principal payments on debt. As our ownership in the two timber funds is 20% of the total capital in those funds, we only include 20% of the ACAD from the funds in our overall ACAD calculation. This assumes that free cash flow from the timber funds is being distributed to fund investors, including Pope Resources. We do not have a target distribution as a percent of ACAD, but note that for 2010 our payout as a percent of ACAD was 42%. So while we increased our quarterly distribution 150% in the third quarter of 2010, we are still comfortably below the level of distributable cash as determined by the ACAD measure. We have further confidence in our ability to maintain our quarterly distribution level based on the assumption that we are entering a period of higher harvest levels and log prices based on stronger export markets and gradual improvement in domestic housing starts.

In the last week of 2010, we capitalized on a rare opportunity to repurchase a large block of our units, representing 7.2% of total units outstanding. We were successful in buying, and then retiring, this 334,340-unit block of POPE units at a price of $35.50 per unit, which represented a slight discount to the market price at that time. We used $2.3 million of cash on hand and tapped our $20 million line of credit for the remaining $9.6 million needed to finance the repurchase of these units. With higher harvest levels and log prices anticipated in 2011, we expect to be in a position to pay down the line of credit borrowing through normal operating activities over the next year or two. We will also consider applying land sales proceeds to the line of credit debt, and/or terming out a portion of the line of credit borrowing as part of our long-term debt. As of the end of the 2011's first quarter, we expect to have repaid nearly half of the amount borrowed through operating cash flows.

At today's distribution payout rate, the "saved" distributions on the repurchased units will be greater than the incremental borrowing cost on the line of credit, thus providing a small annual net cash flow benefit. Although resulting in additional interest expense, the buyback will also be slightly accretive to per-unit earnings when taking into account the lower denominator by which earnings will be calculated on a per-unit basis.

Including this large block repurchase, and dating back to late 2007 when we first initiated a unit repurchase program, we have spent a total of $19.4 million to buy back and retire a total of 589,000 units, or 12.5% of our total units then outstanding. Over this three-year buyback period, our average repurchase cost was just under $33 per unit. Given the deep discount to net asset value that our unit price represents, we continue to view unit repurchases as one of our best uses of capital. At the current unit price, and depending on the valuation treatment of our real estate portfolio, the implied value of our timberland is between $1,300/acre (if the real estate portfolio is valued at twice its book value) and $1,700/acre (if the real estate portfolio is treated the same as the rest of our timberland portfolio). Either of these per-acre amounts represents a substantial discount to market prices of commercial timberland in Washington and Oregon. As described above, there is also the additional benefit of foregone distributions "saved" by repurchasing units.

New Incentive Compensation Program

In the third quarter of 2010, our Board's Human Resources Committee approved a new incentive compensation program for the company's management team. This new incentive compensation program is designed to reward decisions that add to long-term value and to improve alignment with our unitholders. It consists of a performance-based annual restricted unit plan and a three-year incentive compensation plan linked to the total shareholder return of POPE compared with 23 "peer" companies in the forest products sector and several related industries. This new incentive compensation program is described in more detail in our 2010 Form 10-K. We are pleased to unveil this new incentive compensation program and believe it will further enhance our focus on long-term value-adding decisions. I am proud of our management team's direct ownership of nearly 5% of the Partnership's units and believe this new incentive compensation system will further build upon the alignment of interests between management and POPE unitholders.

POPE Celebrates 25th Anniversary

December 2010 marked the 25th anniversary of the spinoff of Pope Resources by Pope & Talbot, Inc. It is worth noting that the company was spawned in the depths of one of the worst cycles for logs and lumber seen in the last 40 years, and in 2010 we were just coming out of a cyclical downturn that rivaled that of the early 1980s. In 1985 we were one of the first timber master limited partnerships, and now find ourselves the last one still standing after a handful have come and gone either due to bankruptcy, asset reversion to corporate sponsors, or conversion to REIT status. Notwithstanding that most publicly traded timber is under a REIT governance structure, we still like the tax efficiency of holding timber inside a partnership vehicle.

The business of managing timberland portfolios and attracting investment capital to this asset class has been a recent evolution in our business strategy. As an organization we have ramped up our sophistication to deal with ever-increasing complexity of rules and regulations that govern both our timber and real estate development worlds. Our fund business has allowed us to leverage this expertise across additional assets without increasing leverage or diluting existing owners through the issuance of additional equity. We are a much less insular company today as a result of cultivating the capability to make the case for investing in the timber asset class to professional investors, a thesis that gets tested and re-tested in this dynamic market environment.

There was a time in our brief history that homebuilding played a significant role in our real estate operations. Since 2001, we have moved away from homebuilding and positioned our real estate efforts solely on the land development side. Successful land development requires a team that is focused on opportunities to maximize the value of land by working closely with the local community and government officials. These same skills have proven essential for attracting conservation dollars to our properties where the sale of a conservation easement provides benefits both to the community and to us as the landowner.

As we enter the next 25 years, I am confident that the company is on a solid foundation to meet the unpredictable challenges that will undoubtedly come our way. I thank our Board, management team, and employees for staying focused on how to add value during this downturn so that we are poised to capitalize on the better times that lie ahead. Finally, I am grateful for the support of our unitholders and always welcome your feedback and questions.

David L. Nunes
President and CEO
March 15, 2011

Management's Discussion and Analysis of Financial Condition and Results of Operations

This report contains a number of projections and statements about our expected financial condition, operating results, and business plans and objectives. These statements reflect management's estimates based upon our current goals, in light of management's knowledge of existing circumstances and expectations about future developments. Statements about expectations and future performance are "forward looking statements" which describe our goals, objectives and anticipated performance. These statements are inherently uncertain, and some or all of these statements may not come to pass. Accordingly, you should not interpret these statements as promises that we will perform at a given level or that we will take any or all of the actions we currently expect to take. Our future actions, as well as our actual performance, will vary from our current expectations, and under various circumstances these variations may be material and adverse. Some of the factors that may cause our actual operating results and financial condition to fall short of our expectations are set forth in that part of our 2010 10-K entitled "Risk Factors." Some of the issues that may have an adverse and material impact on our business, operating results and financial condition include economic conditions that affect consumer demand for our products and the prices we receive for them; government regulation that affects our ability to access our timberlands and harvest logs from those lands; the implications of significant indirect sales to overseas customers, including currency translation, regulatory and tax matters; the effect of financial market conditions on our investment portfolio and related liquidity; environmental and land use regulations that limit our ability to harvest timber and develop property; access to debt financing by our customers as well as ourselves; and the impacts of climate change and natural disasters on our timberlands and on surrounding areas. From time to time we identify other risks and uncertainties in our other filings with the Securities and Exchange Commission. The forward-looking statements in this report reflect our estimates as of the date of the report, and we cannot undertake to update these statements as our business operations and environment change.

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

EXECUTIVE OVERVIEW

Pope Resources, A Delaware Limited Partnership ("we" or the "Partnership"), is engaged in three primary businesses. The first, and by far most significant segment in terms of owned assets and operations, is the Fee Timber segment. This segment includes timberlands owned directly by the Partnership and operations of Fund I and Fund II (the "Funds"). Operations in this segment consist of growing timber to be harvested as logs for sale to export brokers and domestic manufacturers. The second most significant business in terms of total assets owned is the development and sale of real estate. Real Estate activities primarily take the form of securing permits, entitlements, and, in some cases, installing infrastructure for raw land development and then realizing that land's value by the selling of larger parcels to buyers who will take the land further up the value chain, either to home buyers or to operators and lessors of commercial property. Since these land projects span multiple years, the Real Estate segment may incur losses for multiple years while a project is developed until that project is sold, resulting in operating income. Our third business is raising and investing capital from third parties for private equity timber funds and managing the timberland owned by both these funds and unaffiliated owners.

As of December 31, 2010, we owned 114,000 acres of timberland in western Washington, 61,000 acres of timberland for the Funds in Washington and Oregon, plus 2,800 acres of real estate held for sale or development. Our third-party services have historically been conducted in Washington, Oregon, and California.

Net income attributable to unitholders for the year ended December 31, 2010 totaled $2.0 million, or $0.43 per diluted ownership unit, on revenues of $31.2 million. For the corresponding period in 2009, net loss attributable to unitholders totaled $272,000, or $0.07 per diluted ownership unit, on revenues of $20.5 million. For the year ended December 31, 2010, cash flow from operations was $9.0 million, compared to $662,000 in 2009. Net income attributable to unitholders for the quarter ended December 31, 2010 totaled $1.7 million, or $0.35 per diluted ownership unit, on revenues of $8.5 million. This compares to net loss attributable to unitholders for the quarter ended December 31, 2009 that totaled $376,000, or $0.08 per diluted ownership unit, on revenues of $5.2 million.

Our revenues, net income and cash flows increased in 2010 from 2009 and 2008 primarily as a result of an increase in demand for logs in Asian markets, specifically China and Korea. Increased export lumber demand from China also contributed indirectly by helping our sawmill customers increase lumber exports at a time when domestic lumber demand is still soft due to depressed housing markets. Macroeconomic factors that reflect or influence the health of the U.S. housing market and have a bearing on our business revolve around employment growth, tight credits markets, and the supply of foreclosed homes. These factors resulted in record low housing starts in 2009, which negatively impacted our revenues, net income and cash flow. While these macroeconomic factors did not materially improve in 2010, their impact in 2010 on our business was overshadowed by the strength of log export markets and the performance of the U.S. Dollar against currencies of our competitors and customers.

Currency exchange rates influence the competitiveness of our logs in Asian export markets as well as the competitiveness of our domestic sawmill customers in the context of their Asian lumber exports relative to imported lumber from Canada, Europe, or the Southern Hemisphere. Our export logs are sold to domestic intermediaries who then export the logs. Exchange rates impact the ability of these intermediaries to compete in Asian markets with logs that originate from Canada, Russia, or the Southern Hemisphere. In 2010, the U.S. Dollar weakened against the Canadian, Australian and New Zealand Dollars, the Japanese Yen and Korean Won, while strengthening against the Russian Ruble. This relative currency weakness increased the attractiveness of our logs to Asian markets, particularly in China, whose Yuan is indexed to the U.S. Dollar.

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

Our current strategy for adding timberland acreage is centered on our private equity timber fund business model, which consists of raising investment capital from third-party investors and investing that capital, along with our own capital co-investment, into new timberland properties. We have raised two timber funds that have a combined $150 million in assets under management. Our 20% co-investment in the Funds, which totals $28 million, affords us a share of the Funds' operating cash flows while allowing us to earn asset management and timberland management fees as well as incentive fees based upon the overall success of each fund. Management also believes that this strategy allows us to maintain more sophisticated expertise in timberland acquisition, valuation, and management than could be cost-effectively maintained for the Partnership's timberlands alone. Our Real Estate challenges center around how and when to "harvest" a parcel of land and capture the optimum value increment by selling the property, balancing the long-term risks of carrying and developing a property against the potential for income and positive cash flows upon sale.

Our consolidated revenue in 2010, 2009, and 2008, on a percentage basis by segment, was as follows:

Segment	***2010***	*2009*	*2008*
Fee Timber	**89%**	72%	84%
Timberland Management & Consulting	**–%**	3%	3%
Real Estate	**11%**	25%	13%

Additional segment financial information is presented in Note 12 to the Partnership's Consolidated Financial Statements included with this report.

Outlook

We plan to increase harvest volumes in 2011 above the 53 MMBF harvested in 2010. Harvest volume deferred from 2008 to 2010, which totals 50 MMBF, provides us the flexibility to respond to strength in log markets by increasing our harvest level above our current sustainable harvest level of 70 MMBF, which includes 27 MMBF from the Funds. Export log markets are anticipated to offset continued weakness in domestic demand for logs, lumber, and land in 2011. Log markets in early 2011 have risen significantly from the end of 2010. To the extent this strength continues we may choose to increase harvest levels on both the Partnership and Fund properties above our current plan.

We are also anticipating operating results for our Real Estate segment will approximate 2010, as the market for developable land is expected to remain extremely weak in 2011. Until the market improves, we expect to concentrate our Real Estate activities primarily on conservation sales, the sale of conservation easements (CE's), and securing entitlements to our properties while deferring spending on infrastructure improvements wherever possible.

General & Administrative costs in 2011 are expected to decline from 2010, reflecting non-recurring consultant costs to establish a new incentive compensation program and greater initial accrual costs for the multi-year performance cycles.

RESULTS OF OPERATIONS

The following table reconciles net income (loss) attributable to unitholders for the years ended December 31, 2010 to 2009 and 2009 to 2008. In addition to the table's numeric analysis, the explanatory text that follows describes many of these changes by business segment.

Year-to-Year Comparisons *(in thousands)*	***2010 vs. 2009***	*2009 vs. 2008*
Net income (loss) attributable to unitholders		
2010 period	**$2,038**	
2009 period	**(272)**	($272)
2008 period		1,162
Variance	**$2,310**	($1,434)
Detail of earnings variance		
Fee Timber		
Log price realizations (A)	**$4,028**	($3,116)
Log volumes (B)	**8,421**	(2,673)
Depletion	**(3,168)**	1,469
Production costs	**(2,905)**	1,439
Other Fee Timber	**(397)**	311
Timberland Management & Consulting		
Management fee changes	**(531)**	(317)
Other Timberland Management & Consulting	**(344)**	485
Real Estate		
Land and conservation easement sales	**(1,199)**	1,433
Environmental remediation liability	**(845)**	(30)
Timber depletion on HBU sale	**6**	478
Other Real Estate	**(434)**	893
General & administrative costs	**(998)**	218
Net interest expense	**(137)**	(782)
Debt extinguishment costs	**(113)**	(1,137)
Other (taxes, noncontrolling interests, impairment)	**926**	(105)
Total change in earnings	**$2,310**	($1,434)

(A) Price variance calculated by extending the change in average price realized by current period volume.
(B) Volume variance calculated by extending change in sales volume by the average log sales price for the comparison period.

Fee Timber

Revenue and Operating Income

Fee Timber results include operations from 114,000 acres of timberland owned by the Partnership and 61,000 acres of timberland owned by the Funds. Fee Timber revenue is earned primarily from the harvest and sale of logs from these timberlands which are located in western Washington and northwestern Oregon and, to a lesser extent, from the lease of cellular communication towers together with the sale of gravel and other resources from our timberlands. Revenue from sales of timberland tracts will also appear periodically in results for this segment on the relatively infrequent occasions when those transactions occur. Our Fee Timber revenue is driven primarily by the volume of timber harvested. Fee timber expenses, which consist predominantly of depletion, harvest and transportation costs, vary directly and roughly proportionately with harvest volume and the resulting revenues. Revenue and costs related to harvest activities on timberland owned by the Funds are consolidated into this discussion of operations.

Revenue and operating income for the Fee Timber segment for each year in the three-year period ended December 31, 2010, are as follows:

Year ended *(in millions)*	***Log Sale Revenue***	***Mineral, Cell Tower & Other Revenue***	***Total Fee Timber Revenue***	***Operating Income (Loss)***	***Harvest Volume (MBF)***
Pope Resources Timber	**$20.7**	**$1.6**	**$22.3**	**$9.5**	**42,277**
Timber Funds	**5.1**	**0.3**	**5.4**	**0.2**	**10,722**
Total Fee Timber 2010	**$25.8**	**$1.9**	**$27.7**	**$9.7**	**52,999**
Pope Resources Timber	$13.3	$1.5	$14.8	$4.0	32,461
Timber Funds	–	–	–	(0.3)	–
Total Fee Timber 2009	$13.3	$1.5	$14.8	$3.7	32,461
Pope Resources Timber	$16.7	$2.0	$18.7	$6.7	32,455
Timber Funds	2.4	2.4*	4.8	(0.4)	5,293
Total Fee Timber 2008	$19.1	$4.4	$23.5	$6.3	37,748

**Conservation easement sale revenue*

FISCAL YEAR 2010 COMPARED TO 2009. Revenue and operating income increased in 2010 from 2009 due to a 63% increase in harvest volume and a $76 per MBF, or 19%, increase in log prices. Harvest volume increased as both export log markets strengthened relative to 2009 and new export lumber markets to China emerged. The planned harvest for 2010 was 32 MMBF from the Partnership timberlands and no harvest from the Funds, however we responded to improved export and domestic market conditions by harvesting more volume.

Our harvest in 2010 consisted of a relatively high 19.8% of the log volume from the Funds' tree farms, which were purchased much later than the Partnership's properties. The Funds' tree farms have a much higher cost basis and, as such, higher per-unit depletion charge. This resulted in only 2.1% of our Fee Timber operating income coming from the operations of the Funds' timberlands.

FISCAL YEAR 2009 COMPARED TO 2008. Revenue and operating income decreased in 2009 from 2008 due to a 14% lower harvest volume and a $96 per MBF, or 19%, decline in log prices. The decrease in 2009 harvest volume from 2008 was due to continuing weak log markets which caused us to reduce harvest levels in 2009 below our planned harvest level. We originally planned to harvest 37 MMBF in 2009, but as 2009 progressed and log markets weakened below the levels that we had forecasted, we decided to defer additional harvested volume resulting in a 38% harvest deferral in 2009. Log prices declined in 2009 due in part to a decision to harvest a higher proportion of low quality stands that had a higher proportion of lower valued pulpwood. This decision was made in order to preserve more of our higher valued stands that contained more sawlog volume for a point in the future where sawlog prices are higher.

The CE sale completed by Fund I in 2008 is accounted for in the Fee Timber segment due to our policy of including all operations of the Funds in the Fee Timber segment. CE sales and land sales from the Hood Canal and Columbia tree farms made to buyers that plan to preserve the land from future development are accounted for in the Real Estate segment.

ORM TIMBER FUNDS. Due to the Partnership's management and control of the Funds, they are consolidated into our financial statements, with the 80% of these Funds owned by third parties reflected in our Statement of Operations under the caption "Net loss attributable to noncontrolling interest-ORM Timber Funds." Fund II acquired its first properties in October 2009 and, as result, had minimal impact on the consolidated segment performance in 2009 and 2008. We deferred harvesting from each of the Funds' tree farms in 2009 and the first quarter of 2010 in anticipation of weak log markets. However, we began harvesting from the Funds' tree farms during the second quarter of 2010 in response to improvements to domestic and export log markets and continued harvesting through the end of year to take advantage of higher prices. We harvested 11 MMBF from the Funds' tree farms in 2010, no volume in 2009, and 5 MMBF in 2008. The Funds collectively generated revenue of $5.4 million in 2010 compared with $28,000 of revenue in 2009 and $4.8 million of revenue generated in 2008. The 2010 operating income of $166,000 for the Funds is a $460,000 improvement over 2009's operating loss of $294,000 as a result of a 10.7 MMBF increase in harvest volume and a small Fund I land sale in 2010. Fund operating income as a percentage of revenue reflects the high basis relative to the historic Partnership timberlands and, as a result, higher depletion expense than the Partnership timberlands.

Log Volume

Log volume sold for each year in the three-year period ended December 31, 2010 was as follows:

Volume *(in MBF)*	***2010***	***% Total***	*2009*	*% Total*	*2008*	*% Total*
Sawlogs						
Douglas-fir	**34,978**	**66%**	22,383	69%	24,913	66%
Whitewood	**7,096**	**13%**	1,080	3%	3,121	8%
Cedar	**865**	**2%**	827	2%	795	2%
Hardwood	**941**	**2%**	835	3%	977	3%
Pulpwood						
All Species	**9,119**	**17%**	7,336	23%	7,942	21%
Total	**52,999**	**100%**	32,461	100%	37,748	100%

FISCAL YEAR 2010 COMPARED TO 2009. Harvest volume increased 63% from 2009 to 2010. Strong Chinese export markets, and to a lesser extent Korean markets, prompted our decision to increase harvest volume above 2009's level. This strong export market has helped support domestic sawlog prices despite a soft domestic lumber market as domestic sawmills have had to increase log prices to compete for volume diverted to export markets. Many of our sawmill customers are able to afford higher log prices due to the emergence of a new export lumber market in China, for which many of these customers are producing a significant proportion of their overall lumber volume. Log volumes harvested in 2009 included a higher proportion of pulpwood due to our decision to focus harvest on lower quality timber stands to conserve higher value sawlog volume for better market conditions.

FISCAL YEAR 2009 COMPARED TO 2008. Log volume decreased 14% in 2009 from the 2008 harvest as management sought to preserve our asset value while log, lumber, and housing markets continued to decline throughout 2009. We would generally expect the proportion of harvest going to pulpwood markets to average between 10% and 15%. However, in 2009 and 2008 we concentrated our harvest on lower quality timber stands to sell logs into pulpwood markets which were not as dramatically impacted as other log markets by the downturn in housing. As such, pulpwood represented a relatively higher-than-normal proportion of harvest volume for both 2009 and 2008. This shift in weighting of our sort mix lowered the average realized price per MBF below what it might otherwise have been, but allowed more valuable stands to continue to grow in both volume and value.

Log Prices

Logs from the Partnership's tree farms serve a number of different domestic and export markets, with domestic mills historically representing our largest market segment. Throughout 2010, the relative strength of the Chinese export market has been a driving force for much of our log pricing. In contrast to the Japanese export market that has historically only diverted logs to Asia at the top end of the quality spectrum, the Chinese market accepts a log quality that is comparable to that which typically goes to the domestic market. Logs flowing from the Pacific Northwest to China in 2010 increased almost nine-fold from volumes shipped in the comparable period in 2009. Notwithstanding the low level of domestic housing starts, this increased export demand helped to keep upward pressure on domestic log prices throughout 2010.

We have categorized our sawlog volume by species, which is a significant driver of price realized as indicated by the table below. The average log price realized by species for each year in the three-year period ended December 31, 2010 was as follows:

	Fiscal Year			
		Δ from 2009 to 2010		
	2010	*$/MBF*	*%*	*2009*
Sawlogs				
Douglas-fir	**$528**	$93	21%	$435
Whitewood	**446**	137	44%	309
Cedar	**917**	100	12%	817
Hardwood	**502**	56	13%	446
Pulpwood				
All Species	**311**	15	5%	296
Overall	**486**	76	19%	410

	Fiscal Year			
		Δ from 2008 to 2009		
	2009	*$/MBF*	*%*	*2008*
Sawlogs				
Douglas-fir	$435	($102)	-19%	$537
Whitewood	309	(103)	-25%	412
Cedar	817	(428)	-34%	1,245
Hardwood	446	(192)	-30%	638
Pulpwood				
All Species	296	(63)	-18%	359
Overall	410	(96)	-19%	506

The overall log price realized in 2010 increased $76/MBF, or 19%, compared to 2009, primarily due to the same export/domestic market dynamics mentioned above. In addition, the 2009 average log price reflected a high percentage of low value pulpwood compared to that seen in 2010's totals, 23% vs. 17%, respectively. Notwithstanding the overall improvements in year-over-year average log prices from 2009 to 2010, the increase was not sufficient to recover the $96/MBF decline in the average price between 2008 and 2009.

Douglas-fir: Douglas-fir is noted for its structural characteristics that make it generally preferable to other softwoods and hardwoods for the production of construction grade lumber and plywood. Demand and price for Douglas-fir sawlogs has historically been very dependent upon the level of new home construction in the U.S. Douglas-fir log prices realized in 2010 reflect some softening of this direct link between Douglas-fir sawlog prices and domestic housing starts with the dramatic increase in demand for all log species from China.

The rally in Douglas-fir sawlogs began in early 2010 with participants in the domestic supply chain for lumber increasing demand for logs in response to declining inventories. This increase in domestic demand coincided with an increase in export market demand from China, and to a lesser extent Korea. Single-family home starts remained at approximately 500,000 units during 2010, compared to approximately 1.7 million at its peak in 2005. The aforementioned inventory issue was largely addressed by domestic producers in the first quarter of 2010 and with the continued softness in housing starts, we saw sawmills quickly return in the second quarter to lower production levels. In the absence of strong export market demand this would have caused a deeper decline in log prices. There was, however, continued strength in the export market to China which created competition for Douglas-fir sawlogs. The 2010 price realized on Douglas-fir sawlogs was up $93/MBF, or 21%, from 2009 as a result of the aforementioned competition between domestic mills and export markets. This increase nearly reversed the $102/MBF, or 19%, decline in price from 2008 to 2009.

Whitewood: "Whitewood" is a term used to describe several softwood species, but for us primarily refers to western hemlock and spruce. Though generally considered to be of a lower quality than Douglas-fir, these logs are also used for manufacturing lumber and plywood. In addition, the same export market conditions described above have provided for strong whitewood export log demand in China as well as the traditional, but more modest export market for whitewood logs to Korea. The price realized on whitewood sawlogs in 2010 was up $137/MBF, or 44%, versus 2009, also driven by the relative strength in the export log markets in 2010 compared to 2009. The 2010 increase was a large improvement over the $103/MBF, or 25%, decline in price from 2008 to 2009.

Cedar: Cedar is a minor component in most upland timber stands and is generally used for outdoor applications such as fencing, siding and decking. Although there is a link between demand for these products and housing starts, this link is not as strong as with most other softwood species. A small spike in demand from buyers in 2010 helped drive a $100/MBF, or 12%, increase in cedar prices over 2009. While the 2010 increase was welcome, it did not come close to clawing back the $428/MBF, or 34%, decline we saw in cedar prices from 2008 to 2009.

Hardwood: "Hardwood" can refer to many different species, but on our tree farms primarily consists of red alder. The local mills that process red alder sawlogs are using the resource to manufacture lumber for use in furniture and cabinet construction as well as hardwood chips for the pulp and paper industry. In 2010, hardwood sawlog prices increased $56/MBF, or 13%, when compared to 2009 in response to the continued modest demand for lumber, which came at a time when some mills had relatively low inventories 2010. This was a modest improvement over the $192/MBF, or 30%, decline in price from 2008 to 2009.

Pulpwood: Pulpwood is a lower quality log of any species that is manufactured into wood chips. These chips are used primarily to make a full range of pulp and paper products from unbleached linerboard, used in paper bags and cardboard boxes, to fine paper and specialty products. The pulpwood market has enjoyed relative strength over the last couple of years as a direct result of sawmills taking significant downtime in response to the slowdown in housing starts. Sawmills typically provide the bulk of the chips used by pulp manufacturers, so curtailed sawmill production helped to push up the price of pulpwood sold directly to pulp mills. Pulpwood prices were up $15/MBF, or 5%, when compared to the comparable period in 2009. The 2010 increase did not quite return pulpwood prices to those realized in 2008 of $359/MBF but it was a meaningful directional improvement over the $63/MBF, or 18%, decline in pulpwood price from 2008 to 2009.

Customers

Annual harvest volume and average price paid each year in the three-year period ended December 31, 2010 was as follows:

	2010			2009			2008		
Destination	**Volume**	**%**	**Price**	Volume	%	Price	Volume	%	Price
Export brokers	**17,673**	**33%**	**$526**	4,876	15%	$581	5,615	15%	$610
Domestic mills	**26,207**	**50%**	**520**	20,249	62%	410	24,191	64%	531
Pulpwood	**9,119**	**17%**	**311**	7,336	23%	296	7,942	21%	359
Total	**52,999**	**100%**	**$486**	32,461	100%	$410	37,748	100%	$506

FISCAL YEAR 2010 COMPARED TO 2009. Logs sold to export brokers increased to 33% from 15% of volume in 2010 and 2009, respectively, while volume sold to domestic mills declined to 50% from 62% in 2010 and 2009, respectively. This is a direct result of volume diverted to the Chinese and Korean export markets. Export volumes generated a $61/MBF, or 10%, price decrease as a result of the shift from high-quality and high-priced logs sold to Japan in 2009 versus lower quality logs sold into Chinese and Korean markets in 2010. Logs sold to domestic mills increased in price by $116/MBF, or 28%, as domestic mills competed for log volume with the Chinese and Korean export markets. As a percentage of overall volume, we directed fewer logs to the pulpwood market in 2010 compared to 2009, although prices increased $15/MBF, or 5%. As discussed earlier, this was a result of harvesting lower quality timber in 2009 with a higher proportion of pulpwood to preserve higher quality sawlogs for a later time when markets improved.

FISCAL YEAR 2009 COMPARED TO 2008. Volumes by destination showed little relative change in 2009 compared with 2008. Export brokers represent those log buyers that purchase our logs and then resell them to customers in Japan, China, and Korea. This market channel accounted for 15% of both our 2009 and 2008 harvest. Domestic mills purchased 62% of harvest volumes in 2009 versus 64% in 2008. Pulp mills purchased 23% of our harvest volume in 2009 as compared to 21% of 2008.

Log prices realized from export broker sales declined $29/MBF, or 5%, from 2008 to 2009 as the export market shifted from higher priced logs sent to Japan in 2008 to lower priced logs sent to China and Korea in 2009. Log prices realized from domestic mills dropped $121/MBF, or 23%, during that same period as result of the contraction in the housing market which rippled through to domestic sawmills and other wood product manufacturers. Pulpwood prices decreased $63/MBF, or 18%, between 2008 and 2009. Pulpwood prices were artificially high in 2008 as a result of chip shortages early in that year from sawmill downtime.

The export market for logs in the Pacific Northwest has been migrating over the last couple years from a market highly focused on Japan to a market that includes more volume to China and Korea. This change in the export market has resulted in a decline in the premium earned from the sale of logs to the export market while at the same time increasing export market demand for logs sourced in the Pacific Northwest. Sawlogs sold to Korea and China are not of the high quality demanded by the Japanese market and, as a result, do not command the premium pricing generally attributed to the Japanese market. However, this new source of demand for sawlogs in the Pacific Northwest will continue to exert pricing pressure on domestic mills that have been competing with this new and growing offshore source of demand for Pacific Northwest sawlogs. These new outlets for lower quality logs have helped to diversify our customer mix away from domestic mills that are more heavily dependent on the U.S. housing market.

Another way to look at the impact of these growing export markets is to combine the domestic and export log volumes, which increased $79/MBF, or 18%, in value between 2009 and 2010, from $443/MBF in 2009 to $522/MBF in 2010. This nearly approaches the 19% decline in value between 2008 and 2009 of these combined export and domestic log volumes, which declined from $545/MBF in 2008 to $522/MBF in 2009. Over the two-year period from 2008 to 2010, the combined value of export and domestic logs declined by 4%. This decline would have been much steeper had we not had access to these higher levels of export log demand in China and Korea.

Harvest Volumes and Seasonality

The Partnership owns 114,000 acres of timberland in western Washington and the Funds own collectively 61,000 acres of timberland in western Washington and western Oregon. We are able to conduct year-round harvest activities on the Hood Canal tree farm and 12,000 acres of the Funds' properties because these properties are concentrated at low elevations. In contrast, the Columbia tree farm and the balance of the Funds' acres are at a higher elevation where harvest activities are generally not possible during the winter months when snow precludes access to the lands. Generally, we concentrate our harvests from the Hood Canal tree farm in those months when weather limits operations on other properties, thus taking advantage of reduced competition for log supply to our customers and improving prices realized. As such, when these various tree farms are combined, we can operate so that the pattern of quarterly volumes harvested is flatter than would be the case if looking at one tree farm in isolation.

The percentage of annual harvest volume by quarter for each year in the three-year period ended December 31, 2010 was as follows:

Year ended	Q1	Q2	Q3	Q4
2010	**22%**	**27%**	**30%**	**21%**
2009	27%	22%	20%	31%
2008	25%	38%	31%	6%

We entered 2010 with a plan to defer harvest volume in response to our expectation of continued weakness in log markets resulting from a slowdown in housing. That plan called for no harvest from the Funds. However, as the year progressed and export and domestic markets showed improvement, we gradually increased harvest volume commensurate with the increase in demand, which hit its peak in the third quarter. By the third quarter of 2010, we had gained confidence in the impact of the China log market and added volume to meet the surges in export and domestic demand.

In 2009, our harvest was weighted to the first and fourth quarters to take advantage of higher seasonal prices. For 2009, we pushed more than the usual amount of our harvest into the fourth quarter to take advantage of an uptick in market demand and increased prices driven by depleted inventories throughout the supply chain. The absence of company owned mills requiring volume and less concern with quarterly earnings fluctuations allows us to maximize value by making market timing adjustments. Furthermore, our practice of permitting excess harvest units provides maximum flexibility to make changes to harvest volumes.

Harvest volumes in 2008 were weighted to the first three quarters of the year. The precipitous fall-off in the fourth quarter of that year reflects the impact associated with the financial meltdown of 2008.

Cost of Sales

Cost of sales for the Fee Timber segment consists of harvest and haul costs and depletion expense. Harvest, haul, and depletion all vary directly with actual harvest volume. Harvest and haul costs represent the direct cost incurred to convert trees into logs and deliver those logs to their point of sale. Depletion expense represents the cost of acquiring or growing the harvested timber. The applicable depletion rate is derived by dividing the aggregate cost of timber, together with capitalized road expenditures, by the estimated volume of merchantable timber available for harvest at the beginning of that year. The depletion rate is applied to the volume harvested in a given period to calculate depletion expense for that period. Depletion expense is calculated by first deriving a depletion rate as follows:

$$\text{Depletion rate} = \frac{\text{Accumulated cost of timber and capitalized road expenditures}}{\text{Estimated volume of 35-year-and-older merchantable timber}}$$

Each year, the depletion rate is adjusted to account for "layers" of harvest volume exiting the pool and new "layers" of 35-year old timber volume and cost entering the pool. The depletion rate is then applied to future volume harvested to calculate depletion expense.

Fee Timber cost of sales for each year in the three-year period ended December 31, 2010 was as follows:

Year ended (in millions)	Harvest, Haul and Other	Cost of Conservation Easement Sale	Depletion	Total Cost of Sales
2010	$8.9	–	$5.2	$14.1
2009	6.0	–	2.0	8.0
2008	7.5	2.2	3.4	13.1

Cost of sales increased $6.1 million in 2010 from 2009 primarily as a result of a 63% harvest volume increase from 32 MMBF in 2009 to 53 MMBF in 2010, and because we harvested a significant portion of our 2010 harvest from the Funds' timberlands, which have a much higher depletion rate than the Partnership's legacy properties. Depletion expense increased $3.2 million in 2010 relative to 2009. Of this increase, $2.5 million is due to harvest of 11 MMBF from the Funds' tree farms that did not occur in 2009 and $639,000 is due to the harvest volume increase from the Hood Canal and Columbia tree farms. Fee Timber cost of sales decreased $5.1 million in 2009 from 2008 as a result of a 5 MMBF decline in harvest volume in 2009 from 2008 and the non-recurring costs incurred in connection with the CE sale in 2008.

Fee Timber cost of sales, expressed on a per MBF basis for each year in the three-year period ended December 31, 2010, was as follows:

Year ended	Harvest, Haul and Other	Depletion	Total Cost of Sales*
2010	$167	$98	$265
2009	184	62	246
2008	198	91	289

** Total excludes cost of conservation easement sale in 2008*

Harvest costs vary based upon the physical site characteristics of acreage harvested. Harvest units that are difficult to access, or that are located on steep hillsides requiring cable harvest systems, are more expensive to harvest. Haul costs vary based upon the distance between the harvest site and the customer's location. Harvest, haul and other costs per MBF decreased $17/MBF in 2010 relative to 2009. This reduction is attributable to a decrease in pulpwood volume harvested which carries a higher harvest cost per MBF than sawlogs. Per MBF harvest and haul costs were lower in 2009 relative to 2008 due to the selection of less expensive harvest units in the face of weak log pricing.

We use a pooled depletion rate for volume harvested from the Hood Canal and Columbia tree farms that divides the combined book basis of the merchantable timber for both tree farms by the combined merchantable volume for both tree farms. On the other hand, for the Funds we calculate separate depletion rates for each of the six Fund tree farms and then present them for this report in terms of a blended aggregate rate. In 2009, we use and report the pooled depletion rate for volume harvested from the Hood Canal and Columbia tree farms as we had no timber harvest from the Funds' tree farms. In 2008, we report two separate depletion rates, the pooled rate for the Hood Canal and Columbia tree farms and a separate blended rate for volume harvested from tree farms owned by Fund I.

Depletion expense resulting from timber harvest for each year in the three-year period ended December 31, 2010 was made up of the following:

Year ended December 31, 2010	Pooled	Funds	Total
Volume harvested (MBF)	**42,277**	**10,722**	**52,999**
Rate/MBF	**$62**	**$236**	**$98**
Depletion expense *(in thousands)*	**$2,640**	**$2,529**	**$5,169**

Year ended December 31, 2009	Pooled	Total
Volume harvested (MBF)	32,461	32,461
Rate/MBF	$62	$62
Depletion expense *(in thousands)*	$2,001	$2,001

Year ended December 31, 2008	Pooled	Fund I	Total
Volume harvested (MBF)	32,455	5,293	37,748
Rate/MBF	$65	$254	$91
Depletion expense *(in thousands)*	$2,094	$1,343	$3,437

We harvested 53 MMBF of timber in 2010, with 11 MMBF of the total attributable to the Funds' timberlands. This compares to harvest of 32 MMBF in 2009, solely from the Partnership's timberlands, and harvest of 38 MMBF in 2008, with 5 MMBF of the 2008 total attributable to the Fund I timberlands. The Funds' depletion expense in 2010 and Fund I depletion expense in 2008 represent harvest from timberlands owned by the Funds that reflects a higher depletion rate than our combined pool of depletion costs for the Hood Canal and Columbia tree farms. The "Pooled" depletion consists primarily of historical timber cost that has been owned by the Partnership for many decades, as well as the Columbia tree farm property that was acquired in 2001. Depletion for the Funds' timber volume is derived from the cost of timber acquired more recently at a higher overall cost and, therefore, carries a higher depletion rate.

Depletion expense is generated from the harvest and sale of timber and periodically from Real Estate sales when land is sold with standing timber. Depletion expense generated from Real Estate sales, as was the case in 2008, is excluded from the Fee Timber depletion analysis.

Operating Expenses

Fee Timber operating expenses for each of the three years ended December 31, 2010, 2009, and 2008 were $3.8 million, $3.1 million, and $4.2 million, respectively.

Year ended *(in millions)*	2010	2009	2008
Operating expenses	**$3.8**	$3.1	$4.2
Average acres	**162,484**	144,277	137,780
$/Acre	**$23**	$22	$30

Operating expenses for Fee Timber include management, silviculture and the cost of both maintaining existing roads and building temporary roads required for harvest activities for the 114,000 acres owned by the Partnership and the 61,000 acres owned by the Funds. Due to consolidation of the Funds into the Partnership's financial statements the fees generated from the management of the Funds are eliminated from the Fee Timber operating expenses. These management fees were $1.5 million, $908,000, and $946,000 in 2010, 2009, and 2008, respectively. The increase in operating expense in 2010 over 2009 is due to the increase in activities to prepare tree farms for the 63% increase in harvest volume in 2010 relative to 2009. Operating expenses on a per-acre basis remained essentially flat due to the addition of 25,000 acres acquired by Fund II in the third quarter of 2010. Operating costs declined in 2009 from 2008 as a result of cost-cutting measures implemented in the first quarter of 2009. Operating expenses, on a per-acre basis, declined by a slightly greater amount relative to the actual expenses due to the additional acres acquired by Fund II in the fourth quarter of 2009.

Timberland Management & Consulting

Revenue and Operating Income

The Timberland Management & Consulting (TM&C) segment develops timberland property investment portfolios on behalf of the Funds. In addition, we provide our timberland management services to third-party owners of timberland. As of December 31, 2010, the TM&C segment managed two private equity timber funds representing a combined $150 million of assets under management.

Revenue and expense generated through the management of the Funds is accounted for within the TM&C segment, but eliminated as a result of consolidation of the Funds into the Partnership's financial statements. The revenue generated from management of these Funds represents an expense to the Fee Timber segment which is eliminated when the Funds are consolidated into the Partnership's financial statements. Each fund is owned 20% by the Partnership and, as a result, 80% of these management fees are paid by third-party investors. We generated a total of $1.5 million, $908,000, and $946,000 of management fee revenue in 2010, 2009, and 2008, respectively, each of which was eliminated in consolidation along with a corresponding decrease in operating expenses for the Fee Timber segment. At the close of 2010, the TM&C segment was managing 61,000 acres for the Funds compared with 36,000 acres at the end of 2009. We managed approximately 267,000 acres of timberland for Cascade Timberlands LLC (Cascade) and an additional 24,000 acres for Fund I at the end of 2008. Revenue and operating income for the TM&C segment for each year in the three-year period ended December 31, 2010, were as follows:

Year ended December 31 *(in millions)*	***2010***	*2009*	*2008*
Revenue internal	**$1.5**	$1.5	$1.9
Intersegment eliminations	**(1.5)**	(0.9)	(1.0)
Revenue external	**$0.0**	$0.6	$0.9
Operating income-internal	**$0.0**	$0.4	$0.1
Intersegment eliminations	**(1.3)**	(0.8)	(0.6)
Operating loss-external	**($1.3)**	($0.4)	($0.5)

FISCAL YEAR 2010 COMPARED TO 2009. After elimination of revenue generated from managing the Funds, revenue for 2010 was $570,000 lower than in 2009 and operating loss was $875,000 higher than in 2009. The decrease in revenue and increase in operating loss resulted primarily from the termination of our management contract with Cascade Timberlands LLC in July of 2009 and secondarily from an increase in segment operating expenses following acquisition by Fund II of 37,000 acres from the fourth quarter of 2009 through to the third quarter of 2010.

FISCAL YEAR 2009 COMPARED TO 2008. Revenue and operating loss for 2009 were $343,000 and $168,000 lower, respectively, than in 2008. The decrease in revenue is due to the elimination of the Cascade contract in mid-2009. The reduction in operating loss is due primarily to a reduction in expenses associated with formation of Fund II as well as cost-cutting efforts within the segment.

Operating Expenses

FISCAL YEAR 2010 COMPARED TO 2009. TM&C operating expenses increased $305,000 in 2010 from 2009. The increase in operating expense results from a $92 million increase in assets under management following acquisition of four tree farms representing 37,000 acres by Fund II.

FISCAL YEAR 2009 COMPARED TO 2008. TM&C operating expenses decreased $511,000 in 2009 from 2008. This is attributable to elimination of costs following the mid-2009 termination of our Cascade management contract and the aforementioned reduction of expense associated with the formation of Fund II and cost-cutting efforts within the segment.

Real Estate

Revenue and Operating Income

The Partnership's Real Estate segment consists primarily of revenue from the sale of land and sales of CE's from the Partnership's timberland portfolio, together with residential and commercial property rents. Land sales can be for residential purposes or for conservation purposes; in the case of conservation land sales, these are categorized as conservation sales. The Partnership's Real Estate holdings are located primarily in the western Washington counties of Pierce, Kitsap, and Jefferson. Revenue in the Real Estate segment is generated through the sale of land, the rental of homes and commercial properties at the Port Gamble townsite, and the sale of land development rights. Land sales include the sale of unimproved land which generally consists of larger acreage sales rather than single lot sales and are normally completed with very little capital investment prior to sale. Rural residential lot sales generally require some capital improvements such as zoning, road building, or utility access improvements prior to completing the sale. Commercial and residential plat land sales represent land sold after development rights have been obtained and are generally sold with certain infrastructure improvements in place. Sales of development rights can take different forms, but in 2010 reflected the sale of a CE on 6,886 acres of the Columbia tree farm and in 2009 reflected the sale of a CE on 2,290 acres of the Hood Canal tree farm, both of which preclude future real estate development.

Results from Real Estate operations are expected to vary significantly from year to year as we make multi-year investments in entitlements and infrastructure prior to selling entitled or developed land. Revenue and operating income for the Real Estate segment for each year in the three-year period ended December 31, 2010 were as follows (all dollar amounts in millions):

Year ended *(in millions)*	*Revenue*	*Environmental Remediation Expense*	*Operating Income (Loss)*
2010	**$3.5**	**$0.9**	**($0.8)**
2009	5.0	–	1.7
2008	3.7	–	(1.1)

Real Estate segment revenue for each year in the three-year period ended December 31, 2010 consisted of the following:

	Thousands			*Per Acre Amounts*	
Description	*Revenue*	*Gross Margin*	*Acres Sold*	*Revenue*	*Gross Margin*
Conservation easement	**$2,400**	**$2,244**	**6,886**	**$349**	**$326**
Rentals	**1,013**	**1,011**	**NA**		
Other	**74**	**70**	**NA**		
2010 Total	**$3,487**	**$3,325**	**6,886**		

	Thousands			Per Acre Amounts	
Description	*Revenue*	*Gross Margin*	*Acres Sold*	*Revenue*	*Gross Margin*
Conservation easement	$3,298	$3,108	2,290	$1,440	$1,357
Rural residential	521	328	50	10,420	6,566
Rentals	1,154	1,153	NA		
Other	57	49	NA		
2009 Total	$5,030	$4,638	2,340		
Conservation easement	$830	$418	118	$7,034	$3,543
Conservation sale	479	324	75	6,387	4,322
Rural residential	1,147	734	141	8,135	5,206
Rentals	1,158	1,157	NA		
Other	69	71	NA		
2008 Total	$3,683	$2,704	334		

FISCAL YEAR 2010 COMPARED TO 2009. Revenue for the Real Estate segment declined by $1.5 million in 2010 compared to 2009 due to a decline of $898,000 in CE revenue and the absence of 2010 counterparts to 2009's rural residential land transactions. In 2010, we closed a $2.4 million CE on nearly 6,900 acres in Skamania County. Similar to the 2009 CE sale, the 2010 sale was funded by the federal Forest Legacy program and restricts future development on the property while allowing continued management and harvest of timber. The sale provided a gross margin of $2.2 million. The revenue is reported in the Real Estate segment as it was generated through the efforts of our Real Estate development segment and relates to Partnership timberlands. Operating loss increased $2.5 million in 2010 over operating income in 2009. This is due primarily to the $845,000 increase to the environmental remediation accrual, lower revenue realized on CE revenue in 2010 and the absence of 2010 counterparts to 2009 land sales.

FISCAL YEAR 2009 COMPARED TO 2008. In 2009, revenue for the Real Estate segment increased by $1.3 million and operating income increased $2.8 million from 2008 results. The large increase in revenue and operating results is attributed to a 2,290-acre CE sale on our Hood Canal tree farm in the third quarter of 2009 compared to an 118-acre CE sale for $830,000 and two conservation sales totaling $479,000 in 2008. The $3.3 million of CE revenue in 2009 was funded by the federal Forest Legacy program and represents the culmination of five years of negotiation and discussions with Cascade Land Conservancy and the Washington State Department of Natural Resources. Similar to the 2010 CE sale, this CE will protect the land from development while allowing for continued growing and harvesting of timber. Cost-cutting measures in the Real Estate segment served to further increase operating income in 2009 over 2008.

In addition to the CE sale in 2009, there were 3 separate land transactions totaling 50 acres sold from the Rural Residential lot program. This compares to 5 separate land transactions totaling 141 acres sold in 2008. The Partnership's Rural Residential lot program typically produces lots from 5 to 80 acres in size, based on underlying zoning densities. This type of program entails an entitlement effort typically consisting of simple lot segregations and boundary line adjustments. Development activities include minor road building, surveying, and the extension of utilities. Demand for rural lots has dropped significantly since 2007 commensurate with decreased housing demand.

Management intends to offer rural residential lots to the market as appetite for raw land increases. In normal markets we target 150 to 300 acres of rural residential lot sales annually. The market for these types of land sales is expected to remain extremely weak in 2011 and, as a result, we will likely not meet this target in 2011.

Cost of Sales

Real Estate cost of sales for each of the three years ended December 31, 2010, 2009, and 2008 was $162,000, $392,000, and $979,000, respectively, with these amounts comprised of land basis and closing costs. CE sales, unlike land sales which include land basis in costs of sales, typically have little to no cost basis written off as part of the transaction. The step-wise decline in cost of sales from 2008 to 2009 to 2010 is due primarily to a progressive drop over this period in rural residential sales.

Operating Expenses

Real Estate operating expenses for each of the three years ended December 31, 2010, 2009, and 2008, were $3.3 million, $2.9 million, and $3.8 million, respectively. Operating expenses increased $314,000 in 2010 compared to 2009 due to an increase in property taxes following cessation of capitalizing interest, property taxes and insurance to several long-term development projects. Capitalization of interest, property taxes and insurance to long-term development projects stops once the respective projects reach the point of substantial completion or construction activity has been intentionally delayed. Operating expenses decreased $870,000 in 2009 compared to 2008 due primarily to cost-cutting efforts that have been undertaken during this prolonged downturn in the market for raw and developed land.

Basis in Real Estate Projects

"Land Held for Development" on our Consolidated Balance Sheet represents the Partnership's cost basis in land that has been identified as having greater value as development property rather than as timberland. Our Real Estate segment personnel work with local officials to establish entitlements for further development of these parcels. Costs clearly associated with either development or with the construction of fully entitled projects are generally capitalized, whereas costs associated with projects that are in the entitlement phase are generally expensed. Those properties that are either for sale, under contract or the Partnership has an expectation they will sell within the next 12 months, are classified as a current asset under Land Held for Sale.

When facts and circumstances indicate that the carrying value of properties may be impaired, an evaluation of recoverability is performed by comparing the carrying value of such property or properties to the projected future undiscounted cash flows of the same property or properties. If it is determined that the carrying value of such assets may not be fully recoverable, we would recognize an impairment loss, adjusting for changes in estimated fair market value, and would charge this amount against current operations. We have continuously owned most of our land for decades. As a result, the land basis associated with most of our development properties is well below even the weakened current market values prevalent today. As such, we do not anticipate an asset impairment charge on our development projects.

Environmental Remediation

The Partnership has an accrual for estimated environmental remediation costs of $1.9 million and $1.3 million as of December 31, 2010 and 2009, respectively. The environmental remediation liability represents estimated payments to be made to monitor and remedy certain areas in and around the townsite/millsite of Port Gamble, and at Port Ludlow, Washington.

During the fourth quarter of 2010, review continued on the draft Baywide and Millsite Remedial Investigation and Feasibility Study reports related to Port Gamble. The reports have an estimated submission for a 30-day public comment period beginning in March 2011. The public comments will be part of the data that informs a cleanup action plan anticipated to be filed with a consent decree in late 2011. The development of a cleanup action plan includes formalizing cost estimates and how costs will be shared between responsible parties, which will be reflected in the Partnership's environmental remediation accrual liability where and when appropriate.

The environmental remediation accrual contains costs estimated in connection with a second and separate remediation effort at Port Gamble as well as a third site within the resort community of Port Ludlow. We will be completing site investigations and remediating contaminated sites if and where required.

The environmental liability at December 31, 2010 is comprised of $397,000 that the Partnership expects to expend in the next 12 months and $1.5 million thereafter. Statistical models have been used to estimate the liability for the aforementioned matters and suggest a potential aggregate range of loss of $744,000 to $3.8 million. Activity in the environmental remediation liability is detailed as follows:

Year ended December 31 *(in thousands)*	*Balance at Beginning of Year*	*Additions to Accrual*	*Expenditures for Remediation*	*Balance at Year-End*
2010	**$1,269**	**$875**	**$211**	**$1,933**
2009	1,554	30	315	1,269
2008	1,994	–	440	1,554

General & Administrative (G&A)

FISCAL YEAR 2010 COMPARED TO 2009. G&A costs were $4.7 million in 2010 compared to $3.7 million in 2009. This increase includes both the initial accrual for a new long-term incentive compensation plan's multi-year performance cycles and professional service fees associated with development of the new plan. G&A costs represented 15% of revenue in 2010.

FISCAL YEAR 2009 COMPARED TO 2008. G&A costs decreased $218,000, or 6%, to $3.7 million from $4.0 million in 2008. The decrease in G&A expense is due to cost-cutting measures implemented in response to weak log and real estate markets. This decrease was offset by $248,000 of legal expenses incurred in connection with an October 2009 arbitration hearing to resolve a dispute regarding our SLARS investment. G&A costs represented 18% of revenue in 2009.

Interest Income and Expense

Interest income for 2010 decreased to $102,000 from $219,000 in 2009 and $965,000 in 2008. The progressively lower amounts of interest income from 2008 to 2009 to 2010 are due primarily to lower cash and investment balances coupled with a decrease in average interest earned on the portfolio.

Interest expense, net of interest capitalized to development projects, was $1.2 million for 2010, 2009 and 2008. Interest expense, net of interest capitalized, was static from 2008 to 2010 in spite of the addition of an $11 million mortgage by Fund II as a result of a decline in interest expense attributable to a decrease in borrowing rates offset by a decline in interest capitalized as a result of certain Real Estate projects no longer meeting interest capitalization requirements. With the exception of the operating line of credit, the Partnership's debt consists primarily of mortgage debt with fixed interest rates.

Debt Extinguishment Costs

In April 2010, we paid off an $18.6 million mortgage with a 7.63% fixed interest rate, one year ahead of its scheduled maturity. The early retirement of this debt resulted in a $1.2 million debt extinguishment charge. In September 2009, the Partnership incurred $1.1 million of costs in connection with the early retirement of another timberland mortgage, which was also scheduled to mature in April 2011. These separate decisions to refinance were motivated by the opportunity to reduce cash used for both principal and interest payments, lower borrowing costs, and spread out future refinance risk across a number of years. The early debt extinguishment costs were funded in both cases by using new term loans from Northwest Farm Credit Services (NWFCS).

Income Taxes

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

FISCAL YEAR 2010 COMPARED TO 2009. We recorded a tax benefit of $290,000 in 2010 compared to a tax provision of $39,000 in 2009. The tax benefit results from losses in the taxable corporate subsidiaries in 2010.

FISCAL YEAR 2009 COMPARED TO 2008. We recorded an income tax provision of $39,000 in 2009, whereas we recorded a $61,000 tax benefit in 2008. The tax provision recorded in 2009 reflects improved operating results in the subsidiary corporations that manage timberlands owned by the Partnership and Funds.

Noncontrolling interests-ORM Timber Funds

Noncontrolling interests-ORM Timber Funds represented the 80% portion of 2010 and 2009 net losses of the Funds, each of which is attributable to third-party owners of the Funds. The increase in net loss in 2010 is due to an increase in interest expense in Fund II related to a new term loan funded in September 2010 as well as costs incurred to prepare the Funds' tree farms for harvest in 2010. The decrease in this amount from 2008 is due to the decrease in operating loss of the Funds in 2009 as cost-saving measures were implemented in response to weak log markets and the decision to defer all harvest from the Funds' properties.

LIQUIDITY AND CAPITAL RESOURCES

Cash Flows

We ordinarily finance our business activities using funds from operations and, where appropriate in management's assessment, commercial credit arrangements with banks or other financial institutions. Funds generated internally from operations and externally through financing are expected to provide the required resources for the Partnership's future capital expenditures. The Partnership's debt-to-total-capitalization ratio, as measured by the carrying value of timberland, roads and timber, excluding noncontrolling interests and debt of the funds, was 36% at December 31, 2010 versus 26% as of December 31, 2009. The debt-to-total-capitalization ratio as of December 31, 2010 was primarily impacted by the $9.6 million draw on the operating line of credit in late December to fund a $11.9 million block unit repurchase; the expenditure of $11.9 million to repurchase our units in 2010 also served to reduce partners' capital and the ratio's denominator, both of which serve to drive the ratio higher. The Partnership's debt agreements have covenants which are measured quarterly. Among the covenants measured is a requirement that the Partnership not exceed the maximum debt-to-total- capitalization ratio of 30%, with total capitalization defined and calculated as the fair market (vs. carrying) value of timberland, roads and timber. The Partnership is in compliance with this covenant as of December 31, 2010 and expects to remain in compliance for at least the next twelve months. As such, all long-term debt agreements are appropriately classified on the balance sheet.

On April 16, 2010 we used existing cash balances along with proceeds from our operating line of credit to retire the $18.6 million, 7.63% timberland mortgage due in April 2011 held by John Hancock Life Insurance Company (JHLIC). The early retirement of this mortgage triggered $1.2 million of debt extinguishment costs. In June 2010, we entered into a new $20.0 million term loan agreement with NWFCS. The new term loan is comprised of three tranches of varying maturities and weighted average interest rate of 5.26%. In addition to paying off the old loan held by JHLIC, proceeds from the new loan were used to finance the aforementioned debt extinguishment charge and add approximately $200,000 to working capital.

In connection with the new term loan, we elected to extend the Partnership's revolving line of credit with NWFCS from August 2011 to August 2013 and to reduce the maximum borrowing limit from $35 million to $20 million. The line of credit had $9.6 million drawn as of December 31, 2010. The interest rate under this credit facility is variable depending on the interest coverage ratio and uses LIBOR as a benchmark. The spread above the benchmark rate ranges from 225 to 325 basis points. On December 31, 2010, the interest rate applicable to outstanding balances was 2.55%. Management believes that the cash we hold in excess of our current operating needs together with the line of credit provide adequate liquidity for our near-term operating needs.

Simultaneous with a timberland acquisition during the third quarter of 2010, Fund II closed on an $11 million timberland mortgage with MetLife. This mortgage is a non-amortizing, 10-year loan with a fixed interest rate of 4.85%. The agreement allows for, but does not require, annual principal payments of up to 10% without incurring a make-whole premium.

We plan to increase the 2011 harvest above the 53 MMBF harvested in 2010. The decision to increase harvest was made in response to the sawlog market improving due to the recovery of the economy and increased demand from foreign customers. Harvest deferrals from 2008 and 2009 provide us additional volume to comfortably and responsibly increase harvest to respond to market demands.

During the year ended December 31, 2010, overall cash and cash equivalents decreased $4.8 million resulting primarily from the acquisition of timberlands for Fund II. In addition, at the end of 2010 we repurchased a large block of units at a total cost of $11.9 million but financed $9.6 million of this total by drawing on our line of credit, resulting in a net $2.3 million drain on 2010 cash balances. During the year ended December 31, 2009, overall cash and cash equivalents decreased by $10.8 million primarily due to the Fund II co-investment and the repurchase of units. The $6.0 million variance in cash flow from 2010 to 2009 is due primarily to the following:

Change from 2009 to 2010 *(in thousands)*	***Amount***
Increase in cash provided by operations	$8,288
Timberland acquisitions	(23,785)
Partnership units repurchased	(10,429)
Issuance of long-term debt, net of principal payments	20,892
Proceeds from Fund II capital call	11,273
Cash from option exercises	622
Cash distributions	(828)
Other	8
Total	$6,041

OPERATING CASH ACTIVITIES. The table below provides the components of operating cash flows for each annual period ended December 31. Cash received from customers and paid to suppliers and employees results from the harvest and sale of forest products from our tree farms; timberland management, disposition, and consulting services provided to timberland owners; and sales of development properties. Capitalized development activities include investment in our Real Estate properties to build infrastructure and acquire the entitlements necessary to make further development of the properties possible.

Operating cash activities *(in thousands)*	***2010***	*2009*	*2008*
Cash received from customers	**$31,289**	$20,854	$29,071
Cash paid to suppliers and employees	**(19,210)**	(16,533)	(21,281)
Interest received	**103**	280	1,025
Interest paid, net of amounts capitalized	**(903)**	(1,226)	(1,401)
Debt extinguishment costs	**(1,250)**	(1,137)	–
Capitalized development activities	**(1,075)**	(1,639)	(3,451)
Income taxes refunded (paid)	**(4)**	63	(11)
Cash provided by operating activities	**$8,950**	$662	$3,952

Cash provided by operating activities increased to $9.0 million in 2010 from $662,000 in 2009. The increase in cash provided by operating activities resulted primarily from the 63% increase in timber harvest combined with a $564,000 reduction in capitalized development activity and $323,000 reduction in interest paid. The reduction in development activity reflects management strategy to invest at a rate that does not outpace the real estate market. The reduction in interest paid reflects the decline in borrowing rates. We incurred capital expenditures for development costs in 2010 for the following Real Estate properties: $406,000 at Gig Harbor, $29,000 at Kingston, $38,000 at Port Ludlow, $570,000 of capitalized interest related to the Gig Harbor, Kingston, and Port Ludlow projects, and $32,000 related to other miscellaneous projects.

Cash provided by operating activities decreased to $662,000 in 2009 from $4.0 million in 2008. The decrease in cash provided by operating activities resulted primarily from the decrease in timber harvest combined with a $745,000 reduction in interest received as a result of a decline in invested balances and $1.1 million of non-recurring extinguishment of debt costs from the early retirement of a timberland mortgage. These reductions to cash were offset by a $1.8 million decline in capitalized development activities. We incurred capital expenditures for development costs in 2009 for the following Real Estate properties: $238,000 at Gig Harbor, $122,000 at Kingston, $36,000 at Bremerton, $48,000 at Port Ludlow, $1.1 million of capitalized interest related to the Gig Harbor, Kingston and Port Ludlow projects, and $104,000 related to other miscellaneous projects.

INVESTING CASH ACTIVITIES. The table below reflects the annual components of cash used by year in investing activities for each annual period ended December 31. Recurring investing activities consist primarily of timberland acquisitions, investment portfolio liquidations, tree planting, road building, and asset acquisitions.

Investing activities *(in thousands)*	***2010***	*2009*	*2008*
Timber and roads	**($582)**	($617)	($555)
Buildings and equipment	**(359)**	(607)	(1,160)
Timberland acquisitions	**(58,206)**	(34,421)	(904)
Redemption of short-term investments	**1,497**	1,815	26,775
Proceeds from the sale of fixed assets	**–**	50	41
Cash provided by (used in) investing activities	**($57,650)**	($33,780)	$24,197

Cash used in investing activities was $57.7 million in 2010 compared with cash used in investing activities of $33.8 million in 2009. The increase in 2010 from 2009 is due primarily to the acquisition of Fund II properties. This increase was offset by a $283,000 reduction in spending for buildings and equipment and timber and roads as a result of cost management efforts.

Cash used by investing activities decreased to $33.8 million in 2009 from cash provided by investing activities of $24.2 million in 2008. The decrease in 2009 from 2008 is due primarily to the acquisition of Fund II properties and a decline in redemption of SLARS. In 2009, we liquidated $1.8 million in SLARS versus 2008 when we liquidated $26.8 million in SLARS. During 2009, we invested $607,000 in timber and roads and approximately $617,000 in other capital expenditures.

FINANCING ACTIVITIES. The table below summarizes the components of cash used in financing activities for each year of the three-year period ended December 31, 2010. Our financing activities primarily reflect cash received in connection with long-term debt and Partners' capital.

Financing activities *(in thousands)*	***2010***	*2009*	*2008*
Cash distributions to unitholders	**($3,241)**	($3,219)	($7,444)
ORM Timber Fund II, Inc. capital call	**38,800**	27,527	370
ORM Timber Funds distributions	**(806)**	–	(800)
Proceeds from line of credit	**9,600**	–	–
Unit repurchases	**(12,267)**	(1,838)	(3,940)
Repayment of long-term debt	**(1,038)**	(1,418)	(1,342)
Extinguishment of long-term debt	**(18,554)**	(8,478)	–
Proceeds from issuance of long-term debt	**31,000**	9,800	–
Debt issuance costs	**(283)**	(71)	–
Cash received from unit option exercises	**622**	–	644
Excess tax benefit from equity-based compensation	**–**	17	167
Preferred stock issuance – ORM Timber Fund II, Inc.	**125**	–	–
Preferred stock distribution – ORM Timber Fund II, Inc.	**(15)**	–	–
Cash provided by (used in) financing activities	**$43,943**	$22,320	($12,345)

Cash provided by financing activities was $43.9 million in 2010 as compared to cash provided by financing activities of $22.3 million in 2009. This change is due primarily to the issuance of long-term debt, net of principal payments and the Fund II capital call. The increase is offset by an increase in unit repurchases in 2010 from 2009.

Cash provided by financing activities was $22.3 million in 2009 as compared to cash used in financing activities of $12.3 million in 2008. This change is due primarily to the capital call of $27.5 million by Fund II investors for the acquisition of timberland properties. This was in addition to the $4.2 million reduction in cash distribution to unitholders and the $2.1 million reduction in unit repurchases from 2008. Cash distributions went from $1.60 per unit in 2008 to $0.70 per unit in 2009. The unit repurchases made in 2009 were part of a program which was extended in May 2009 and concludes in December 2011.

Expected future changes to cash flows

OPERATING ACTIVITIES. As discussed above, we plan to increase our harvest level in 2011. This increase is in response to the improving log market, especially driven by increased demand from foreign customers. Our budgeted capital expenditures for our Gig Harbor and Port Ludlow projects are expected to total $586,000 and $108,000, respectively, in 2011. The majority of Gig Harbor capital expenditure in 2011 is projected to be capitalized interest on the property. Capitalized interest will make up more than half the expenditures on the Port Ludlow property in 2011 where activities will primarily relate to continuation of entitlement efforts and planning for future construction.

INVESTING ACTIVITIES. Management has budgeted $1.3 million of capital expenditures for 2011. These investments are primarily comprised of long-term investments supporting our fee timber operations; there are no planned property acquisitions for 2011.

FINANCING ACTIVITIES. Management is currently projecting that cash on hand, availability of drawing on the operating line of credit, and cash generated from operating activities will be sufficient to bridge the front-loading of the capital needs for development properties and co-investments in future timber funds.

Excluding noncontrolling interests and debt of the Funds, our debt-to-total-capitalization ratio as of December 31, 2010 was 36% and 12% as measured, respectively, by book value and market value of assets. Should a financing need arise, management is comfortable that there is room to take on additional debt with the ratios at these levels. Portions of the Hood Canal and Columbia tree farms secure the Partnership's current timberland mortgages and, in the case of Fund II, portions of Fund II's tree farms secure the MetLife timberland mortgage. To date, the Partnership's strong financial position has enabled fairly easy access to credit at reasonable terms when needed.

Seasonality

FEE TIMBER. The Partnership owns 114,000 acres of timberland in western Washington and the Funds own collectively 61,000 acres of timberland in western Washington and western Oregon. We are able to conduct year-round harvest activities on the Hood Canal tree farm and 12,000 acres of the Funds' properties because these properties are concentrated at low elevations. In contrast, the Columbia tree farm and the balance of the Funds' acres are at a higher elevation where harvest activities are generally not possible during the winter months when snow precludes access to the lands. Generally, we concentrate our harvests from the Hood Canal tree farm in those months when weather limits operations on other properties, thus taking advantage of reduced competition for log supply to our customers and improving prices realized. As such, when these various tree farms are combined, we can operate so that the pattern of quarterly volumes harvested is flatter than would be the case if looking at one tree farm in isolation.

TIMBERLAND MANAGEMENT & CONSULTING. Management revenue generated by this segment is made up of asset and timberland management fees. These fees, which primarily relate to our activities on behalf of the Funds and are eliminated in consolidation, vary based upon the amount of capital managed, the number of acres managed, and the volume of timber harvested from properties owned by the Funds and are not expected to be significantly seasonal.

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

Contractual Obligations, Commercial Commitments and Contingencies

Our commitments at December 31, 2010 consist of operating leases, and purchase obligations entered into in the normal course of business.

	Payments Due By Period /Commitment Expiration Date				
Obligation or commitment *(in thousands)*	***Total***	***Less than 1 year***	***1–3 years***	***4–5 years***	***After 5 years***
Total debt	$50,498	$30	$9,668	$5,000	$35,800
Operating leases	66	51	15	–	–
Interest on debt	21,518	2,462	4,344	3,915	10,796
Environmental remediation	1,933	397	1,536	–	–
Other long-term obligations	210	25	50	50	86
Total contractual obligations or commitments	$74,225	$2,965	$15,613	$8,965	$46,682

Environmental remediation represents our estimate of potential liability associated with environmental contamination at Port Gamble and Port Ludlow. There may be certain monitoring activity beyond three years, but we are unable to estimate the timing and amounts at this time. Other long-term obligations consist of a $210,000 liability for a supplemental employment retirement plan.

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

Off-Balance Sheet Arrangements

The Partnership is not a party to off-balance sheet arrangements other than the operating leases disclosed above and does not hold any variable interests in unconsolidated entities.

Capital Expenditures and Commitments

Projected capital expenditures in 2011 are $2.2 million, of which $476,000 is capitalized interest costs. Projected capital expenditures are currently expected to include $586,000 for the Gig Harbor site and $108,000 for Port Ludlow developments, of which $460,000 and $16,000 are capitalized interest, respectively. Interest capitalization ceases once projects reach the point of substantial completion or construction activity has been intentionally delayed. These expenditures could be increased or decreased as a consequence of future economic conditions. Projected capital expenditures are subject to permitting timetables and progress towards closing on specific land sale transactions.

Government Regulation

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

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

ACCOUNTING MATTERS

Accounting Standards Not Yet Implemented

There are no accounting standards not yet implemented that are expected to materially impact the Partnership.

Critical Accounting Policies and Estimates

Management believes its most critical accounting policies and estimates are as follows:

PURCHASED TIMBERLAND COST ALLOCATION. When the Partnership acquires timberlands, a purchase price allocation is performed that allocates cost between the categories of merchantable timber, pre-merchantable timber, and land based upon the relative fair values pertaining to each of the categories. When timberland is acquired the land is separately evaluated for current value. Land value may include uses other than timberland including potential CE sales and development opportunities.

DEPLETION. Depletion represents the cost of timber harvested and the cost of the permanent road system that is charged to operations by applying a depletion rate to volume harvested during the period. The depletion rate is calculated on January 1st of each year by dividing the Partnership's cost of merchantable timber and the cost of the permanent road system by the volume of merchantable timber. For purposes of the depletion calculation in 2010, merchantable timber is defined as timber that is equal to or greater than 35 years of age.

To calculate the depletion rate, the Partnership uses a combined pool when the characteristics of the acquired timber are not significantly different from the Partnership's existing timberlands. The depletion cost on recently acquired timber, such as timber harvested from the Funds is higher than the Partnership's timberlands and may at times approximate the net stumpage realized on the sale.

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

The standing inventory system is subject to two processes each year to monitor accuracy. The first is the annual cruise process and the second is a comparison of (a) volume actually extracted by harvest to (b) inventory in the standing inventory system at the time of the harvest. A "cruise", which utilizes statistical sampling techniques, represents a physical measurement of timber on a specific set of acres. The cruise process is completed when the physical measurement totals are compared to the volume captured in the standing inventory system. Only productive acres with timber that is at least 20 years old are selected as subject to a cruise. The Partnership cruises 10–20% of its productive acres with 25-year-old or greater timber annually. Specific acres are first selected for cruising with a bias towards those acres that have gone the longest without a cruise and, second, with a bias towards those acres that have been growing the longest. As the cruise is being performed, only those trees with a breast height diameter (approximately 4.5 feet from the ground) of at least 6 inches are measured for inclusion in the inventory.

A hypothetical 5% change in estimated timber inventory volume would have changed 2010 depletion expense by $146,000.

ENVIRONMENTAL REMEDIATION. The Partnership has an accrual for estimated environmental remediation costs of $1.9 million and $1.3 million as of December 31, 2010 and 2009, respectively. The environmental remediation liability represents estimated payments to be made to monitor and remedy certain areas in and around the townsite/millsite of Port Gamble, and at Port Ludlow, Washington.

During the fourth quarter of 2010, review continued on the draft Baywide and Millsite Remedial Investigation and Feasibility Study reports related to Port Gamble. The reports have an estimated submission for a 30-day public comment period beginning in early March 2011. The public comments will be part of the data that informs a cleanup action plan anticipated to be filed with a consent decree in late 2011. The development of a cleanup action plan includes formalizing cost estimates and how costs will be shared between responsible parties, which will be reflected in the Partnership's environmental remediation accrual liability where and when appropriate.

The environmental remediation accrual contains costs estimated in connection with a second and separate remediation effort at Port Gamble as well as a third site within the resort community of Port Ludlow. We will be completing site investigations and remediating contaminated sites if and where required.

The environmental liability at December 31, 2010 is comprised of $397,000 that the Partnership expects to expend in the next 12 months and $1.5 million thereafter. Statistical models have been used to estimate the liability and suggest a potential aggregate range of loss of $744,000 to $3.8 million.

PROPERTY DEVELOPMENT COSTS: The Partnership is developing several master planned communities with the Gig Harbor, Kingston, and Port Gamble projects being the most notable currently. Costs of development, including interest, are capitalized for these projects and allocated to individual lots based upon their relative preconstruction value. This allocation of basis supports, in turn, the computation of those amounts reported as a current vs. long-term asset ("Land Held for Sale" and "Land Held for Development", respectively). As lot sales occur, the allocation of these costs becomes part of cost of sales attributed to individual lot sales.

Costs associated with land including acquisition, project design, architectural costs, road construction, capitalized interest and utility installation are accounted for as operating activities on our statement of cash flows.

PERCENTAGE OF COMPLETION REVENUE RECOGNITION: The partnership accounts for revenue recognized from development sales consistent with the accounting standards relating to the sales of real estate. When a real estate transaction is closed with significant outstanding obligations to complete infrastructure or other construction, revenue is recognized on a percentage of completion method by calculating a ratio of costs incurred to total costs expected. Revenue is deferred proportionately based on the remaining costs to complete the project. During 2010, there was no revenue recognized using the percentage of completion method, nor were there any sales where revenue will be subsequently recognized using the percentage of completion method.

IMPAIRMENT OF LONG LIVED ASSETS: The Partnership evaluates its long lived assets for impairment in accordance with accounting standards. The standards require recognition of an impairment loss in connection with long-lived assets used in a business when the carrying value exceeds the estimated future undiscounted cash flows attributable to those assets over the expected useful life. The Partnership obtains annual appraisals of its timberlands and compares the appraised value of those properties to the carrying value to determine if an asset impairment charge is necessary. The long-term holding period of timberland properties makes an asset impairment unlikely as the undiscounted expected cash flows from a timberland property would need to decrease very significantly to not total in excess of the carrying value of a timber property. When facts and circumstances indicate the carrying value of properties may be impaired, an evaluation of recoverability is performed by comparing the carrying value of the property to the projected future undiscounted cash flows. Upon indication that the carrying value of such assets may not be recoverable, the Partnership would recognize an impairment loss, determined on the basis of fair market value, and charge this amount against current operations. The land basis associated with most of our development properties is well below current market value; therefore, an asset impairment charge on one of our development projects is not likely.

CONSOLIDATION OF ORM TIMBER FUND I, LP (FUND I) AND ORM TIMBER FUND II, INC. (FUND II): Fund I and Fund II are owned 19% by Pope Resources, A Delaware Limited Partnership, 1% by Olympic Resource Management LLC (a wholly owned subsidiary of the Partnership), and 80% by third-party investors. Olympic Resource Management LLC is the general partner of Fund I and the manager of Fund II. Third-party investors do not have the right to dissolve these Funds or otherwise remove the general partner/manager without cause nor do they have substantive participating rights in major decisions of Fund I or Fund II. Based upon this governance structure, Olympic Resource Management LLC has presumptive control of Fund I and Fund II and, as a result, under accounting rules Fund I and Fund II must be consolidated into the Partnership's financial statements.

INCENTIVE COMPENSATION. The Human Resources Committee adopted a new incentive compensation program in 2010. The program has two components — the Performance Restricted Unit ("PRU") plan and the Long-Term Incentive Plan ("LTIP"). Both components have a long-term emphasis, with the PRU plan focused on annual decision making and performance, and the LTIP focused on 3-year performance of the Partnership's publicly traded units relative to a group of peer companies. Compensation expense relating to the performance restricted units will be recognized over the four-year future service period. The first equity grants pursuant to this new program were not made until January 2011 and, as such, no equity compensation expense related to this program was recognized in 2010. As of December 31, 2010, we had accrued $1.5 million, with $200,000 of that total attributable to the cash component of the PRU element and the balance of $1.3 million attributable to the LTIP portion.

Consolidated Balance Sheets

Years ended December 31 (in thousands)	***2010***	*2009*
ASSETS		
Current assets		
Pope cash and cash equivalents	**$237**	$6,035
ORM Timber Funds cash and cash equivalents	**2,186**	1,145
Cash and cash equivalents	**2,423**	7,180
Student loan auction rate securities, current	**–**	690
Accounts receivable, net	**543**	261
Land held for sale	**3**	367
Current portion of contracts receivable	**219**	320
Prepaid expenses and other	**805**	468
Total current assets	**3,993**	9,286
Properties and equipment, at cost		
Land held for development	**27,737**	25,872
Land	**33,980**	25,072
Roads and timber, net of accumulated depletion of $60,044 and $54,743	**164,961**	120,457
Buildings and equipment, net of accumulated depreciation of $7,739 and $7,321	**3,854**	3,967
Total properties and equipment, at cost	**230,532**	175,368
Other assets		
Contracts receivable, net of current portion	**652**	1,140
Student loan auction rate securities, non-current	**–**	796
Other	**660**	490
Total other assets	**1,312**	2,426
Total assets	**$235,837**	$187,080
LIABILITIES AND PARTNERS' CAPITAL		
Current liabilities		
Accounts payable	**$868**	$586
Accrued liabilities	**2,656**	808
Current portion of environmental remediation liabilities	**397**	200
Current portion of long-term debt	**30**	831
Deferred revenue	**674**	469
Other current liabilities	**191**	196
Total current liabilities	**4,816**	3,090
Long-term debt, net of current portion	**50,468**	28,659
Environmental remediation liabilities, net of current portion	**1,536**	1,069
Other long-term liabilities	**210**	205
Commitments and contingencies		
Partners' capital:		
General partners' capital (units issued and outstanding 60 and 60)	**992**	1,089
Limited partners' capital (units issued and outstanding 4,203 and 4,520)	**69,998**	82,037
Noncontrolling interests	**107,817**	70,931
Total partners' capital and noncontrolling interests	**178,807**	154,057
Total liabilities, partners' capital, and noncontrolling interests	**$235,837**	$187,080

See accompanying notes to consolidated financial statements.

Consolidated Statements of Operations

Years ended December 31 (in thousands, except per unit information)	***2010***	*2009*	*2008*
Revenue			
Fee Timber	**$27,674**	$14,847	$23,551
Timberland Management & Consulting	**31**	601	944
Real Estate	**3,487**	5,030	3,683
Total revenue	**31,192**	20,478	28,178
Costs and expenses			
Cost of sales			
Fee Timber	**(14,184)**	(7,980)	(13,092)
Real Estate	**(162)**	(392)	(979)
Total cost of sales	**(14,346)**	(8,372)	(14,071)
Operating expenses			
Fee Timber	**(3,787)**	(3,143)	(4,165)
Timberland Management & Consulting	**(1,281)**	(976)	(1,487)
Real Estate	**(3,259)**	(2,945)	(3,815)
Environmental remediation	**(875)**	(30)	–
General & Administrative (G&A)	**(4,731)**	(3,733)	(3,951)
Total operating expenses	**(13,933)**	(10,827)	(13,418)
Operating income (loss)			
Fee Timber	**9,703**	3,724	6,294
Timberland Management & Consulting	**(1,250)**	(375)	(543)
Real Estate	**(809)**	1,663	(1,111)
General & Administrative (G&A)	**(4,731)**	(3,733)	(3,951)
Total operating income	**2,913**	1,279	689
Other income (expense)			
Interest expense	**(1,815)**	(2,317)	(2,469)
Interest capitalized to development projects	**569**	1,091	1,279
Interest income	**102**	219	965
Net gain (loss) on student loan auction rate securities dispositions	**11**	(66)	–
Impairment of student loan auction rate securities	**–**	(252)	(381)
Total other expense	**(1,133)**	(1,325)	(606)
Debt extinguishment costs	**(1,250)**	(1,137)	–
Income (loss) before income taxes	**530**	(1,183)	83
Income tax benefit (expense)	**290**	(39)	61
Net income (loss)	**820**	(1,222)	144
Net loss attributable to noncontrolling interests – ORM Timber Funds	**1,218**	950	1,018
Net income (loss) attributable to unitholders	**$2,038**	($272)	$1,162
Allocable to general partners	**27**	(4)	15
Allocable to limited partners	**2,011**	(268)	1,147
Earnings (loss) per unit attributable to unitholders			
Basic	**$0.43**	($0.07)	$0.23
Diluted	**$0.43**	($0.07)	$0.23
Distributions per unit	**$0.70**	$0.70	$1.60

See accompanying notes to consolidated financial statements.

Consolidated Statements of Partners' Capital and Comprehensive Income (Loss)

Years ended December 31 (in thousands)	***Attributable to Pope Resources*** General Partners	Limited Partners	Noncontrolling Interests	Total
December 31, 2007	$1,244	$95,400	$45,802	$142,446
Net income and comprehensive income	30	1,132	(1,018)	144
Cash distributions	(96)	(7,348)	(800)	(8,244)
Capital call	–	–	370	370
Excess tax benefit from equity-based compensation	2	165	–	167
Equity-based compensation	8	576	–	584
Unit repurchases	(51)	(3,889)	–	(3,940)
Proceeds from option exercises	9	635	–	644
December 31, 2008	$1,146	$86,671	$44,354	$132,171
Net loss and comprehensive loss	(4)	(268)	(950)	(1,222)
Cash distributions	(42)	(3,177)	–	(3,219)
Capital call	–	–	27,527	27,527
Excess tax benefit from equity-based compensation	1	16	–	17
Equity-based compensation	12	609	–	621
Unit repurchases	(24)	(1,814)	–	(1,838)
December 31, 2009	$1,089	$82,037	$70,931	$154,057
Net income and comprehensive income	**64**	**1,974**	**(1,218)**	**820**
Cash distributions	**(42)**	**(3,199)**	**(821)**	**(4,062)**
Proceeds from option exercises	**19**	**603**	**–**	**622**
Preferred stock issuance	**–**	**–**	**125**	**125**
Capital call	**–**	**–**	**38,800**	**38,800**
Equity-based compensation	**22**	**690**	**–**	**712**
Unit repurchases	**(160)**	**(12,107)**	**–**	**(12,267)**
December 31, 2010	**$992**	**$69,998**	**$107,817**	**$178,807**

Weighted average units outstanding	**12/31/10**	12/31/09	12/31/08
Basic	**4,554**	4,539	4,597
Diluted	**4,578**	4,539	4,661

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Years ended December 31 (in thousands)	***2010***	*2009*	*2008*
Cash flows from operating activities			
Cash received from customers	**$31,289**	$20,854	$29,071
Cash paid to suppliers and employees	**(19,210)**	(16,533)	(21,281)
Interest received	**103**	280	1,025
Interest paid, net of amounts capitalized	**(903)**	(1,226)	(1,401)
Debt extinguishment costs	**(1,250)**	(1,137)	-
Capitalized development activities	**(1,075)**	(1,639)	(3,451)
Income taxes received (paid)	**(4)**	63	(11)
Net cash provided by operating activities	**8,950**	662	3,952
Cash flows from investing activities			
Capital expenditures	**(941)**	(1,224)	(1,715)
Proceeds from sale of fixed assets	**–**	50	41
Redemption of short-term investments	**1,497**	1,815	26,775
Timberland acquisitions by ORM Timber Funds	**(58,206)**	(34,421)	(904)
Net cash provided by (used in) investing activities	**(57,650)**	(33,780)	24,197
Cash flows from financing activities			
Cash distributions to unitholders	**(3,241)**	(3,219)	(7,444)
Capital call- ORM Timber Fund II, Inc.	**38,800**	27,527	370
Cash distributions- ORM Timber Funds	**(806)**	–	(800)
Borrowings on line of credit	**9,600**	–	–
Unit repurchases	**(12,267)**	(1,838)	(3,940)
Repayment of long-term debt	**(1,038)**	(1,418)	(1,342)
Extinguishment of long-term debt	**(18,554)**	(8,478)	–
Proceeds from issuance of long-term debt	**31,000**	9,800	–
Debt issuance costs	**(283)**	(71)	–
Proceeds from option exercises	**622**	–	644
Excess tax benefit from equity-based compensation	**–**	17	167
Preferred stock issuance – ORM Timber Fund II, Inc.	**125**	–	–
Preferred stock distribution – ORM Timber Fund II, Inc.	**(15)**	–	–
Net cash provided by (used in) financing activities	**43,943**	22,320	(12,345)
Net increase (decrease) in cash and cash equivalents	**(4,757)**	(10,798)	15,804
Cash and cash equivalents			
Beginning of year	**7,180**	17,978	2,174
End of year	**$2,423**	$7,180	$17,978

See accompanying notes to consolidated financial statements.

Schedule to Consolidated Statements of Cash Flows

Years ended December 31 (in thousands)	***2010***	*2009*	*2008*
Reconciliation of net income (loss) to net cash provided by operating activities			
Net income (loss)	**$820**	($1,222)	$144
Depletion	**5,169**	2,001	3,915
Equity-based compensation	**712**	621	584
Excess tax benefit from equity-based compensation	**–**	(17)	(167)
Depreciation and amortization	**642**	810	774
Write-off of debt issuance costs	**32**	–	–
(Gain) loss on student loan auction rate securities	**(11)**	318	381
Deferred taxes, net	**(252)**	(222)	(143)
Cost of land sold	**67**	127	2,614
Capitalized development activities	**(1,075)**	(1,639)	(3,451)
Increase (decrease) in cash from changes in operating accounts			
Deferred revenue	**205**	126	(63)
Accounts receivable	**(282)**	239	385
Contracts receivable	**174**	11	571
Prepaid expenses and other current assets	**(71)**	(138)	5
Accounts payable and accrued liabilities	**2,157**	(45)	(1,526)
Other current liabilities	**(6)**	35	53
Environmental remediation	**664**	(285)	(440)
Other long-term liabilities	**5**	(31)	(62)
Other long-term assets	**–**	(6)	384
Other, net	**–**	(21)	(6)
Net cash provided by operating activities	**$8,950**	$662	$3,952

See accompanying notes to consolidated financial statements.

Notes To Consolidated Financial Statements

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of operations

Pope Resources, A Delaware Limited Partnership (the "Partnership") is a publicly traded limited partnership engaged primarily in managing timber resources on its own properties as well as those owned by others. Pope Resources' active subsidiaries include ORM, Inc., which is responsible for managing Pope Resources' timber properties; Olympic Resource Management LLC, which provides timberland management and consulting activities and is responsible for developing the timber fund business; Olympic Property Group I, LLC, which manages the Port Gamble townsite and millsite and land that is held as development property; and OPG Properties LLC, which owns land that is held as development property. These consolidated financial statements also include the Funds. With respect to Fund I, Olympic Resource Management LLC is the general partner and owns 1% while Pope Resources owns 19%. Olympic Resource Management LLC is the manager of Fund II and owns 1% while Pope Resources owns 19%. The purpose of both Funds is to invest in timberlands. See Note 3 for additional information.

The Partnership operates in three business segments: Fee Timber, Timberland Management & Consulting, and Real Estate. Fee Timber represents the growing and harvesting of trees from owned properties. Timberland Management & Consulting represents management, acquisition, disposition, and consulting services provided to third-party owners of timberland and provides management services to Fund I and Fund II once timberland is acquired. Real Estate consists of obtaining entitlements for properties that have been identified as having value as developed residential or commercial property and operating the Partnership's existing commercial property in Kitsap County, Washington.

Principles of consolidation

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

General partner

The Partnership has two general partners: Pope MGP, Inc. and Pope EGP, Inc. In total, these two entities own 60,000 partnership units. The allocation of distributions, income and other capital related items between the general and limited partners is pro rata among all units outstanding. The managing general partner of the Partnership is Pope MGP, Inc. and it receives an annual management fee of $150,000 as compensation for performing its duties as managing general partner.

Noncontrolling interests

Noncontrolling interests represents the 80% interest in Fund I and Fund II owned by third-party investors. These entities are consolidated into Pope Resources' financial statements due to our control over the entities (see Note 3).

Significant estimates and concentrations in financial statements

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

Cost of sales

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

Concentration of credit risk

Financial instruments that potentially subject the Partnership to concentrations of credit risk consist principally of accounts and contracts receivable. The Partnership limits its credit exposure by considering the creditworthiness of potential customers. The Partnership's allowance for doubtful accounts is $10,423 and $8,779 at December 31, 2010 and 2009, respectively.

Contracts receivable

The Partnership sells land parcels under contracts requiring minimum cash down payments of 20% to 25% at interest rates between 7% and 8.75% per annum. While one contract has a repayment term of 15 years, loans are typically structured with repayments based on a 20-year amortization schedule culminating in a balloon payment within 5 to 7 years. The Partnership reduces credit risk on contracts through down payment requirements and utilizing the underlying land as collateral.

At December 31, 2010, minimum principal payments on contracts receivable for the next five years and thereafter are due as follows (in thousands):

2011	$219
2012	23
2013	194
2014	307
2015	9
Thereafter	119
Total	$871

Income taxes

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

Property and equipment

Depreciation is provided using the straight-line method over the estimated useful lives of the assets, which range from 3 to 39 years.

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

Buildings and equipment consisted of the following as of December 31, 2010 and 2009 (in thousands):

Description	***12/31/2010***	*12/31/2009*
Buildings	**$8,177**	$7,996
Equipment	**2,795**	2,676
Furniture and fixtures	**621**	617
Total	**$11,593**	$11,289
Accumulated depreciation	**(7,739)**	(7,321)
Net buildings and equipment	**$3,854**	$3,967

Timber and roads

The depletion rate is calculated by dividing estimated merchantable timber inventory into the cost basis of merchantable inventory as of the beginning of the year. The Partnership capitalizes the cost of building permanent roads on the tree farms and expenses temporary roads and road maintenance. Capitalized roads are depleted as timber is harvested. The road depletion rate is calculated by dividing the cost of capitalized roads at the beginning of the year by merchantable timber inventory. The resulting rate is applied to timber harvested during the year to determine road depletion expense. To calculate the depletion rate the Partnership uses a combined pool when the characteristics of the acquired timber are not significantly different from the Partnership's existing timberlands. Timber harvested by the Funds is accounted for and depleted separate from the Partnership's timberlands due to the third-party owners in the Funds.

Land held for development or sale

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

Deferred revenue

Deferred revenue represents the unearned portion of revenue collected. The balance at December 31, 2010 of $674,000 and December 31, 2009 of $469,000 primarily represents the unearned portion of the amounts received on cell tower leases and to a lesser extent deferred revenue on land sales.

Revenue recognition

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

Land and CE sales

The Partnership considers the sale of land and CE's to be part of its normal operations and therefore recognizes revenue from such sales and cost of sales for the Partnership's basis in the property sold. Cash generated from these sales is included in cash flows from operations on the Partnership's statements of cash flows. Similarly, investments to acquire land to be held for sale or development, as well as costs incurred to develop those properties, are also included in cash flows from operations within the statements of cash flows.

In December 2010, the Partnership sold a $2.4 million CE on nearly 6,900 acres in Skamania County. The sale was funded by the federal Forest Legacy program and restricts future development on the property while allowing continued management and harvest of timber. The sale provided a gross margin of $2.2 million. The revenue is reported in the Real Estate segment.

Equity-based compensation

The Partnership issues restricted units to certain employees, officers, and directors of the Partnership as part of their annual compensation. Restricted units are valued on the grant date at the market closing price of the partnership units on that date. The value of the restricted units is amortized to compensation expense during the vesting period which can range from two to four years. Grants to retirement-eligible individuals are expensed immediately.

On the date of grant, these restricted units are owned by the employee, officer, or director of the Partnership, subject to a trading restriction that is in effect during the vesting period. As of December 31, 2010, total compensation expense related to non-vested awards not yet recognized was $516,000 with a weighted average 11 months remaining to vest.

Comprehensive income (loss)

Comprehensive income (loss) consists solely of net income (loss).

Income per partnership unit

Basic net earnings (loss) per unit are based on the weighted average number of units outstanding during the period. Diluted net earnings (loss) per unit is calculated by dividing net income (loss) attributable to unitholders, adjusted for non-forfeitable distributions paid out to unvested restricted unitholders and dividends paid to Fund II preferred shareholders, by the weighted average units outstanding during the year plus additional units that would have been outstanding assuming the exercise of in-the-money unit equivalents using the treasury stock method.

The table below displays how we arrived at options used to calculate dilutive unit equivalents and subsequent treatment of dilutive unit equivalents based on net income (loss) for the period:

Year ended December 31 *(in thousands)*	***2010***	*2009*	*2008*
Average per unit trading price	**$30.80**	$21.07	$27.29
Total options outstanding	**47,874**	163,053	166,053
Less: options with strike price above average trading price (out-of-the-money)	**(1,464)**	(41,323)	(1,869)
Options used in calculation of dilutive unit equivalents	**46,410**	121,730	164,184
Net income (loss) attributable to Pope Resources' unitholders	**$2,038**	($272)	$1,162
Dilutive unit equivalents	**24**	42	64
Less: unit equivalents considered anti-dilutive due to net loss in period	**–**	(42)	–
Dilutive unit equivalents used to calculate dilutive EPS	**24**	–	64

The following table shows how we arrived at basic and diluted income per unit:

Year ended December 31 *(in thousands)*	***2010***	*2009*	*2008*
Net income (loss) attributable to Pope Resources' unitholders	**$2,038**	($272)	$1,162
Nonforfeitable distributions paid to unvested restricted unitholders	**(45)**	(39)	(99)
Dividends paid to Fund II preferred shareholders	**(15)**	–	–
Net income (loss) attributable to outstanding unitholders	**$1,978**	($311)	$1,063
Weighted average units outstanding (in thousands):			
Basic	**4,554**	4,539	4,597
Dilutive effect of unit equivalents	**24**	–	64
Diluted	**4,578**	4,539	4,661
Earnings (loss) per unit: Basic	**$0.43**	($0.07)	$0.23
Earnings (loss) per unit: Diluted	**$0.43**	($0.07)	$0.23

For 2010, options to purchase 1,464 units at prices ranging from $30.98 to $37.73 were not included in the calculation of dilutive unit equivalents as they were anti-dilutive. This is compared with 2009, when options to purchase 41,323 units at prices ranging from $21.35 to $37.73 were not included and 2008, when options to purchase 4,869 units at prices ranging from $27.88 to $37.73 were not included in the calculation of dilutive unit equivalents as they were anti-dilutive.

Statements of cash flows

The Partnership considers all highly liquid debt instruments with a maturity of three months or less when purchased to be cash equivalents. Non-cash investing activities for the year ended December 31, 2008 included the following:

- *$596,000 held in trust by an IRC Section 1031 exchange facilitator as of December 31, 2007 used to acquire timberlands as of March 31, 2008.*
- *$360,000 for capital improvements accrued in 2007 and paid in 2008. This amount is partially offset by $70,000 of accrued investing activity in 2008 and paid in 2009.*
- *$203,000 of long-term debt incurred in 2008 relating to a cost-share reimbursement to the City of Tacoma for bridge construction ensuring continued access to Fund I property.*

Fund II Preferred Shares

Fund II issued 125 par $0.01 shares of its 12.5% Series A Cumulative Non-Voting Preferred Stock (Series A Preferred Stock) at $1,000 per share for total proceeds of $125,000 in March 2010. Each holder of the Series A Preferred Stock is entitled to a liquidation preference of $1,000 per share. Dividends on each share of Series A Preferred Stock will accrue on a daily basis at the rate of 12.5% per annum. Upon redemption, the Series A Preferred Shares will be settled in cash and are not convertible into any other class or series of shares or Partnership units. Redemption timing is controlled by Fund II. The maximum amount that the consolidated subsidiary could be required to pay to redeem the instruments upon settlement is $125,000 plus accrued but unpaid dividends. The Series A Preferred Stock is recorded within noncontrolling interests on the consolidated balance sheet and are considered participating securities for purposes of calculating earnings (loss) per share.

Accounting pronouncements adopted in 2010

On January 4, 2010, the FASB issued Accounting Standards Update No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820) — Improving Disclosures about Fair Value Measurements (ASU 2010-06)*. ASU 2010-06 requires additional disclosure within the roll forward activity for assets and liabilities measured at fair value on a recurring basis, including transfers of assets and liabilities between Level 1 and Level 2 of the fair value hierarchy and the separate presentation of purchases, sales, issuances and settlements of assets and liabilities within Level 3 of the fair value hierarchy. In addition, ASU 2010-06 requires enhanced disclosures of the valuation techniques and inputs used in the fair value measurements within Level 2 and Level 3. ASU 2010-06 was adopted for the Partnership's first quarter ending March 31, 2010, except for the disclosure of purchases, sales, issuances and settlements of Level 3 measurements, for which disclosures are not required until the Partnership's first quarter of fiscal 2011. During 2010, the Partnership did not have any transfers of assets or liabilities between Level 1 and Level 2 of the fair value hierarchy. The adoption of the additional disclosures for Level 1 and Level 2 fair value measurements did not have an impact on the Partnership's financial position, results of operations or cash flows. The Partnership is currently evaluating the potential impact of the disclosures regarding Level 3 fair value measurements.

Multiple Deliverables Arrangements (Topic 605 of ASU 2009-13) — was issued in September 2009. This update provides application guidance on whether multiple deliverables exist, how the deliverables should be separated and how the consideration should be allocated to one or more units of accounting. This guidance also eliminates the residual method of allocation and requires that arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method.

This accounting standard is effective for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. This guidance is effective for us on January 1, 2011, however management does not believe that there will be a significant impact of this new standard on the Partnership's financial position, results of operations, cash flows, or disclosures.

In July 2010, the FASB also issued an initial draft of new financial statement presentation requirements. These new requirements, as currently drafted, would substantially change the way financial statements are presented by disaggregating information in financial statements to explain the components of its financial position and financial performance. These changes will impact the presentation of the financial statements only and are not expected to impact the Company's overall financial position, results of operations, or cash flows.

Reclassifications

Certain prior year amounts have been reclassified to conform to the 2010 presentation including allocations between GP and LP in the Statement of Partners' Capital and Comprehensive Income (loss).

2. CASH, CASH EQUIVALENTS, AND INVESTMENTS

Cash, cash equivalents, and investments held at December 31, 2010 and 2009 were as follows (in thousands):

		December 31, 2010	
	Amortized Cost	***Gross Unrealized Loss***	***Estimated Fair Value***
Cash and cash equivalents	**$2,423**	**$–**	**$2,423**

		December 31, 2009	
	Amortized Cost	*Gross Unrealized Loss*	*Estimated Fair Value*
Cash and cash equivalents	$7,180	$–	$7,180
Securities maturing after ten years			
Auction rate securities, current	925	(235)	690
Auction rate securities, non-current	1,000	(204)	796

During 2010, we liquidated the remaining $1.5 million of auction rate securities held as of December 31, 2009 resulting in a realized gain of nearly $11,000. This realized gain resulted from the following three transactions:

Date	***Description***	***Proceeds***	***Basis***	***Gain/(Loss)***
Jan 21st	Pennsylvania Higher Education	$25,000	$18,653	$6,347
Jan 28th	Pennsylvania Higher Education	702,000	671,490	30,510
Mar 5th	Brazos	770,000	796,100	(26,100)
	Total	$1,497,000	$1,486,243	$10,757

For the same period in 2009, we reported an unrealized loss of $252,000 in addition to a $66,000 realized loss.

ASC 820 *Fair Value Measurements and Disclosures* was followed to determine the fair value of the Partnership's investments. ASC 820 defines a hierarchy of three levels of evidence used to determine fair value:

- *Level 1 – quoted prices for identical assets/liabilities in active markets*
- *Level 2 – quoted prices in a less active market, quoted prices for similar but not identical assets/liabilities, observable inputs other than quoted prices*
- *Level 3 – significant unobservable inputs including the Partnership's own assumptions in determining the fair value of investments*

Under current credit market conditions, there is limited market data for SLARS, thus available Level 1 inputs for use in determining a market value were not available historically. Specific securities under the general description of SLARS are unique and there are no actively traded markets that one can observe to determine a value for a specific security unless a transaction is identified for the security held within our portfolio. We sold one security during the fourth quarter of 2009 and used that transaction as a Level 2 indicator of value for the rest of the portfolio. The following table provides the fair value measurements of applicable Partnership financial assets according to the levels defined in ASC 820 as of December 31, 2010 and 2009:

December 31, 2010 *(in thousands)*	***Level 1***	***Level 2***	***Level 3***	***Total***
Cash and cash equivalents	**$2,423**	**$–**	**$–**	**$2,423**
Total financial assets at fair value	**$2,423**	**$–**	**$–**	**$2,423**

December 31, 2009 *(in thousands)*	*Level 1*	*Level 2*	*Level 3*	*Total*
Cash and cash equivalents	$7,180	$–	$–	$7,180
Auction rate securities, current	–	690	–	690
Auction rate securities, non-current	–	796	–	796
Total financial assets at fair value	$7,180	$1,486	$–	$8,666

The table below summarizes the change in the consolidated balance sheet carrying value associated with Level 3 financial assets for the annual periods ended December 31, 2010 and 2009:

Activity for Securities Valued Using Level 3 Inputs *(in thousands)*	***2010***	*2009*
Balance at beginning of period	**$–**	$3,619
Transfers into Level 3	**–**	–
Transfers out of Level 3	**–**	(1,486)
Dispositions	**–**	(1,815)
Unrealized losses	**–**	(252)
Realized losses on dispositions	**–**	(66)
Balance at end of period	**$–**	$–

3. ORM TIMBER FUND I, LP (FUND I) AND ORM TIMBER FUND II, INC. (FUND II)

The Funds were formed by Olympic Resource Management LLC (ORMLLC) for the purpose of attracting investor capital to purchase timberlands. The objective of these Funds is to generate a return on investments through the acquisition, management, value enhancement and sale of timberland properties. Both Funds will operate for a term of ten years from the end of the drawdown period. The drawdown period for Fund I ended on August 1, 2007 and the drawdown period for Fund II will end in March 2011 or after Fund II is fully invested, whichever occurs sooner.

Pope Resources and ORMLLC together own 20% of each Fund and both are consolidated into the Partnership's financial statements. The Funds' statements of operations for the years ended December 31, 2010, 2009, and 2008 reflect losses of $1.3 million, $1.2 million, and $1.3 million, respectively. These losses include management fees paid to ORMLLC of $1.5 million, $908,000, and $946,000 for 2010, 2009, and 2008, respectively, which are eliminated in consolidation.

The Partnership's consolidated financial statements included Fund I and Fund II assets and liabilities at December 31, 2010 and 2009, which were as follows:

(in thousands)	***2010***	*2009*
Cash	**$2,186**	$1,145
Other current assets	**413**	38
Timber, land, and roads (net of $5,141 and $2,612 of accumulated depletion in 2010 and 2009)	**144,063**	88,342
Other long-term assets	**141**	6
Total assets	**$146,803**	$89,531
Current liabilities excluding long-term debt	**$954**	$741
Current portion of long-term debt	**30**	29
Total current liabilities	**984**	770
Long-term debt	**11,068**	98
Funds' equity	**134,751**	88,663
Total liabilities and equity	**$146,803**	$89,531

4. LONG-TERM DEBT

(in thousands)	At December 31, **2010**	2009
Pope Resources debt		
Mortgages payable to NWFCS, collateralized by timberlands, as follows:		
Five-year tranche, interest at 4.10% with monthly interest-only payments. Matures in July 2015.	**$5,000**	$–
Seven-year tranche, interest at 4.85% with monthly interest-only payments. Matures in July 2017.	**5,000**	–
Ten-year tranche, interest at 6.40%, collateralized by timberlands with monthly interest-only payments. Matures September 2019.	**9,800**	9,800
Fifteen-year tranche, interest at 6.05% with monthly interest-only payments. Matures in July 2025.	**10,000**	–
Total NWFCS debt	**29,800**	9,800
Mortgage payable to JHLIC, interest at 7.63%, collateralized by timberlands with monthly interest payments and annual principal payments. Repaid in April 2010.	**–**	19,303
Local improvement district assessments, with interest ranging from 5.03% to 6.5%.	**–**	260
Operating line of credit, variable interest rate based on LIBOR variable plus 2.25%, with monthly interest-only payments. Matures August 2013.	**9,600**	–
Total Partnership debt	**39,400**	29,363
ORM Timber Funds debt		
Fund I note payable to the City of Tacoma, with interest at 4.5%, with monthly principal and interest payments maturing January 2014.	**98**	127
Fund II mortgage payable to MetLife, interest at 4.85%, collateralized by Fund II timberlands with quarterly interest payments maturing September 2020.	**11,000**	–
Total ORM Timber Funds debt	**11,098**	127
Consolidated subtotal	**50,498**	29,490
Less current portion	**(30)**	(831)
Consolidated long-term debt	**$50,468**	$28,659

The Partnership's debt agreements contain a covenant which requires the Partnership not to exceed a maximum debt-to-total- capitalization ratio of 30%, with total capitalization defined and calculated as the fair market (vs. carrying) value of timberland, roads and timber . The Partnership is in compliance with this covenant as of December 31, 2010 and expects to remain in compliance for at least the next 12 months.

Fund II's debt agreements contain a requirement to maintain a loan-to-value ratio of less than 40%. Fund II is in compliance with this covenant as of December 31, 2010 and expects to remain in compliance for at least the next 12 months.

At December 31, 2010, principal payments on long-term debt for the next five years and thereafter are due as follows (in thousands):

2011	$30
2012	32
2013	9,633
2014	3
2015	5,000
Thereafter	35,800

On April 16, 2010 we used existing cash balances along with proceeds from our operating line of credit to retire the $18.6 million, 7.63% timberland mortgage due in April 2011 held by JHLIC. The early retirement of this mortgage triggered $1.2 million of debt extinguishment costs. In June 2010, we entered into a new $20.0 million term loan agreement with the NWFCS. The new term loan is comprised of three tranches of varying maturities and weighted average interest rate of 5.26%. In addition to paying off the old loan held by JHLIC, proceeds from the new loan were used to finance the aforementioned debt extinguishment charge and add approximately $200,000 to working capital.

In connection with the new term loan, we elected to extend the Partnership's revolving line of credit with NWFCS from August 2011 to August 2013 and to reduce the maximum borrowing limit from $35 million to $20 million. The line of credit had $9.6 million drawn as of December 31, 2010. This unsecured revolving loan agreement has a debt covenant that requires maintenance of a maximum debt-to-total-capitalization ratio of 30%, with total capitalization calculated using fair market value of timberland, which the Partnership passed at December 31, 2010. The interest rate under this credit facility uses LIBOR as a benchmark. The spread above the benchmark rate is variable depending on the interest coverage ratio but ranges from 225 to 325 basis points. As of December 31, 2010 the rate (benchmark plus the spread) was 255 basis points.

As part of the debt refinancing and the reduction in borrowing capacity, the Partnership wrote off unamortized loan fees of $32,000.

Simultaneous with a timberland acquisition during the third quarter of 2010, Fund II closed on an $11 million timberland mortgage with MetLife. The mortgage is a non-amortizing 10-year loan with an interest rate of 4.85%. The agreement allows for, but does not require, annual principal payments of up to 10% without incurring a make-whole premium.

Accrued interest relating to all debt instruments was $453,000 at December 31, 2010, and is included in accrued liabilities.

5. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Partnership's financial instruments include cash and cash equivalents, short-term investments, and accounts receivable, for which the carrying amount of each represents fair value based on current market interest rates or their short-term nature. Carrying amounts of contracts receivable, although long-term, also approximate fair value. The fair value of the Partnership's and Funds' fixed-rate debt having a carrying value of $40.9 million and $29.5 million has been estimated based on current interest rates for similar financial instruments to be approximately $41.9 million and $30.5 million as of December 31, 2010 and 2009, respectively.

6. INCOME TAXES

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

(in thousands)	**2010**	2009	2008
Income (loss) before income taxes	**$530**	($1,183)	$83
Less: Income/(loss) earned in entities that pass through pre-tax earnings to the partners	**1,408**	(1,263)	144
Income (loss) subject to income taxes	**($878)**	$80	($61)

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

(in thousands)	**2010**	2009	2008
Current	**$38**	($278)	($249)
Deferred	**252**	222	143
Paid in capital	**–**	17	167
Total	**$290**	($39)	$61

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

	2010	2009	2008
Statutory tax on income	**34%**	34%	34%
Income earned in entities that pass through pre-tax earnings to the partners	**(67%)**	(37%)	(107%)
Effective income tax rate	**(33%)**	(3%)	(73%)

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

(in thousands)	**2010**	2009	2008
Current (included in prepaid expenses and other)	**$401**	$111	$100
Non current (included in other assets)	**335**	373	162
Total	**$736**	$484	$262

The deferred tax assets are comprised of the following:

(in thousands)	**2010**	*2009*	*2008*
Employee-related accruals	**$647**	$403	$205
Depreciation	**38**	25	7
Other	**51**	56	50
Total	**$736**	$484	$262

The Partnership has concluded that it is more likely than not that its deferred tax assets will be realizable and thus no valuation allowance has been recorded as of December 31, 2010. This conclusion is based on anticipated future taxable income and tax planning strategies to generate taxable income, if needed. The partnership will continue to reassess the need for a valuation allowance during each future reporting period.

7. UNIT INCENTIVE PLAN

The Partnership's 2005 Unit Incentive Plan (the "Plan") authorized the granting of nonqualified equity compensation to employees, officers, and directors of the Partnership. A total of 1,105,815 units have been reserved for issuance under the Plan of which there are 1,005,044 units authorized but unissued as of December 31, 2010. The Partnership issued 26,200 restricted units in two grants under the Plan in 2010. One of the 2010 grants vests over two years with 50% vesting after one year and the remaining 50% vesting after the second year from the grant date provided the grantee is still an employee as of the vesting date. The other grant vests over four years with 50% vesting on the third anniversary and the remaining 50% vesting on the fourth, provided the grantee remains an employee, officer, or director as of the vesting date. Two of the 2009 unit grants vest over four years with 50% vesting on the third anniversary and the remaining 50% vesting on the fourth, provided the grantee remains an employee, officer, or director as of the vesting date. One of the 2009 unit grants vests over two years with 50% vesting after one year and the remaining 50% vesting after the second year from the grant date provided the grantee is still an employee, officer, or director as of the vesting date. The grantee may not transfer restricted units until the holder fulfills the vesting requirements.

One of the two components of the new incentive compensation program adopted in 2010 is the PRU plan. Compensation expense relating to the performance restricted units will vest 25% per year over a 4 year future service period. The first equity grants pursuant to this new program were not made until January 2011 and, as such, no equity compensation expense related to this program was recognized in 2010. As of December 31, 2010, we had accrued $1.5 million in accrued liabilities relating to the 2010 incentive compensation program, with $200,000 of that total attributable to that portion of the PRU that is paid out in cash. See discussion in Item 11.

The new incentive compensation program does not affect the existence or availability of the 2005 Unit Incentive Plan or change its terms. The 2005 Unit Incentive Plan provides a one-way linkage to the new program because it (2005 Plan) has already established the formal framework by which unit grants, options, etc., can be issued. More specifically, the 2005 Plan has an impact on the mechanics of how that portion of the new program that awards equity is implemented.

Restricted Units

The Human Resources Committee makes awards of restricted units to certain employees, plus the officers and directors of the Partnership and its subsidiaries. The restricted unit grants vest over two to four years and are compensatory in nature. Restricted unit awards entitle the recipient to full distribution rights during the vesting period but are restricted from disposition and may be forfeited until the units vest. The fair value, which equals the market price at date of grant, is charged to income on a straight line basis over the vesting period. Grants to retirement-eligible individuals are expensed immediately.

Restricted unit activity for the three years ended December 31, 2010 was as follows:

	Units	Weighted Avg Grant Date Per Unit Fair Value ($)
Outstanding December 31, 2007	53,250	37.27
Grants	19,500	32.99
Vested, net of units tendered back	(8,896)	33.87
Tendered back to pay tax withholding	(479)	37.13
Forfeited	(1,500)	37.15
Outstanding December 31, 2008	61,875	36.42
Grants	11,695	20.52
Vested, net of units tendered back	(16,196)	34.32
Tendered back to pay tax withholding	(1,179)	33.98
Outstanding December 31, 2009	56,195	33.76
Grants	**26,200**	**25.15**
Vested, net of units tendered back	**(16,334)**	**38.29**
Tendered back to pay tax withholding	**(1,388)**	**39.24**
Outstanding December 31, 2010	**64,673**	**29.01**

Unit Options

There were 1,005,044, 1,028,744, and 1,037,918 units available for issuance under the 2005 Unit Incentive Plan as of December 31, 2010, 2009, and 2008 respectively. Unit options have not been granted since December 2005. Unit options granted prior to January 1, 2006 were non-qualified options granted at an exercise price not less than 100% of the fair value on the grant date. Unit options granted to employees vested over four or five years. Directors had the option of receiving their annual retainer in the form of unit options and those options vested immediately as they were granted monthly for services rendered during the month. Options granted have a life of ten years.

	Options	Per Unit Exercise Price ($)
Vested December 31, 2007	199,856	15.97
Unvested December 31, 2007	6,200	15.96
Outstanding December 31, 2007	206,056	15.97
Exercised	(40,003)	16.08
Vested	6,200	15.96
Outstanding and Vested December 31, 2008	166,053	16.08
Expired	(3,000)	27.88
Outstanding and Vested December 31, 2009	163,053	15.86
Exercised	**(75,692)**	**14.96**
Expired	**(2,500)**	**24.13**
Tendered back to pay exercise price and tax withholding*	**(36,987)**	**18.46**
Outstanding and Vested December 31, 2010	**47,874**	**14.85**

** Upon exercise of options, grantees have the choice of tendering back units to pay for their option exercise price and tax on gain. Tax withholding is calculated at the minimum statutory rate.*

There are no unvested unit options at December 31, 2010.

The aggregate spread between the option exercise price and unit market price (intrinsic value) of all options outstanding with a positive intrinsic value at December 31, 2010 was $1.0 million. There were 75,692 options exercised during 2010. The weighted average remaining contractual term for all outstanding and exercisable options at December 31, 2010 was 2.0 years.

8. PARTNERSHIP UNIT REPURCHASE PLANS

The Partnership adopted a unit repurchase plan in December 2008 pursuant to which was authorized to repurchase limited partner units with an aggregate value of up to $2.5 million. Since that time, we have increased the aggregate value of units authorized for repurchase to $5 million and extended the repurchase plan to allow for repurchases through December 2011. As of December 31, 2010, there remained an unutilized authorization for unit repurchases of $2.5 million.

In addition to the December 2008 unit repurchase plan, the Partnership repurchased 334,340 units from a single shareholder on December 31, 2010 for $35.50 per unit which excludes a $0.05 per unit commission paid on settlement. The units represent 7.2% of the total units outstanding at that time and were retired.

9. EMPLOYEE BENEFITS

As of December 31, 2010 all employees of the Partnership and its subsidiaries are eligible to receive benefits under a defined contribution plan. During the years 2008 through 2010, the Partnership matched 50% of employees' contributions up to 8% of an individual's compensation. The Partnership's contributions to the plan amounted to $123,000, $131,000, and $150,000 for the years ended December 31, 2010, 2009, and 2008, respectively.

10. COMMITMENTS AND CONTINGENCIES

Environmental remediation

The Partnership has an accrual for estimated environmental remediation costs of $1.9 million and $1.3 million as of December 31, 2010 and 2009, respectively. The environmental remediation liability represents estimated payments to be made to monitor and remedy certain areas in and around the townsite/millsite of Port Gamble, and at Port Ludlow, Washington.

During the fourth quarter of 2010, review continued on the draft Baywide and Millsite Remedial Investigation and Feasibility Study reports related to Port Gamble. The reports have an estimated submission for a 30-day public comment period beginning in early March 2011. The public comments will be part of the data that informs a cleanup action plan anticipated to be filed with a consent decree in late 2011. The development of a cleanup action plan includes formalizing cost estimates and how costs will be shared between responsible parties, which will be reflected in the Partnership's environmental remediation accrual liability where and when appropriate.

The environmental remediation accrual contains costs estimated in connection with a second and separate remediation effort at Port Gamble as well as a third site within the resort community of Port Ludlow. We will be completing site investigations and remediating contaminated sites if and where required.

The environmental liability at December 31, 2010 is comprised of $397,000 that the Partnership expects to expend in the next 12 months and $1.5 million thereafter. Statistical models have been used to estimate the liability and suggest a potential aggregate range of loss of $744,000 to $3.8 million.

Performance bonds

In the ordinary course of business, and as part of the entitlement and development process, the Partnership is required to provide performance bonds to ensure completion of certain public facilities. The Partnership had performance bonds of $340,000 and $428,000 outstanding at December 31, 2010 and 2009 respectively.

Operating leases

The Partnership has non-cancelable operating leases for automobiles, office space, and computer equipment. The lease terms are from 12 to 48 months. Rent expense under the operating leases totaled $79,000, $105,000, and $127,000 for the years ended December 31, 2010, 2009 and 2008, respectively.

At December 31, 2010 future annual minimum rental payments under non-cancelable operating leases were as follows:

Year	***Amount***
2011	51,000
2012	15,000
2013	–
2014	–

Supplemental Employee Retirement Plan

The Partnership has a supplemental employee retirement plan for a retired key employee. The plan provides for a retirement income of 70% of his base salary at retirement after taking into account both 401(k) and Social Security benefits with a fixed payment set at $25,013 annually. The Partnership accrued $31,000 and $43,000 in 2010 and 2009, respectively, for this benefit based on an approximation of the cost of purchasing a life annuity paying the aforementioned benefit amount. The balance of the projected liability as of December 31, 2010 and 2009 was $211,000 and $205,000, respectively.

Contingencies

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

11. RELATED PARTY TRANSACTIONS AND NONCONTROLLING INTEREST

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

12. SEGMENT AND MAJOR CUSTOMER INFORMATION

The Partnership's operations are classified into three segments: Fee Timber, Timberland Management & Consulting, and Real Estate. The Fee Timber segment consists of the harvest and sale of timber from both the Partnership's 114,000 acres of fee timberland in Washington and the Funds' 61,000 acres in Washington and Oregon.

The Timberland Management & Consulting segment provides investment management, disposition, and technical forestry services in connection with 24,000 acres for Fund I and 37,000 acres for Fund II.

The Real Estate segment's operations consist of management of development properties and the rental of residential and commercial properties in Port Gamble and Kingston, Washington. Real Estate manages a portfolio of 2,800 acres of higher-and-better-use properties as of December 31, 2010. All of the Partnership's real estate activities are in the State of Washington.

For the year ended December 31, 2010, the Partnership had one customer that represented 24% of consolidated revenue, or $7.6 million. The revenue was generated by the Fee Timber segment. For the year ended December 31, 2009, the Partnership had two customers that represented 16% and 10% of consolidated revenue, or $3.3 million and $2.1 million, respectively. The revenues from both customers were generated by the Fee Timber segment.

Identifiable assets are those used exclusively in the operations of each industry segment or those allocated when used jointly. The Partnership does not allocate cash, accounts receivable, certain prepaid expenses, or the cost basis of the Partnership's administrative office for purposes of evaluating segment performance. Intersegment transactions are valued at prices that approximate the price that would be charged to a major third-party customer. Details of the Partnership's operations by business segment for the years ended December 31 were as follows (in thousands):

	2010	*2009*	*2008*
Revenue			
Partnership Fee Timber	**22,474**	14,977	19,282
Funds Fee Timber	**5,370**	31	4,845
Total Combined Fee Timber	**27,844**	15,008	24,127
Timberland Management & Consulting	**1,519**	1,509	1,890
Real Estate	**3,535**	5,078	3,723
Total Revenue (Internal)	**32,898**	21,595	29,740
Elimination of Intersegment Revenue	**(1,706)**	(1,117)	(1,562)
Total Revenue (External)	**31,192**	20,478	28,178
Intersegment Revenue or Transfers			
Partnership Fee Timber	**(170)**	(161)	(577)
Funds Fee Timber	**–**	–	–
Total Combined Fee Timber	**(170)**	(161)	(577)
Timberland Management & Consulting	**(1,488)**	(908)	(946)
Real Estate	**(48)**	(48)	(39)
Total Intersegment Revenue or Transfers	**(1,706)**	(1,117)	(1,562)
Operating Income (Loss)			
Partnership Fee Timber	**9,657**	4,131	7,217
Funds Fee Timber	**(1,307)**	(1,185)	(1,278)
Total Combined Fee Timber	**8,350**	2,946	5,939
Timberland Management & Consulting	**55**	355	138
Real Estate	**(761)**	1,711	(1,437)
G&A	**(4,731)**	(3,733)	(3,951)
Total Operating Income (Internal)	**2,913**	1,279	689

	2010	2009	2008
Intersegment Charges or Transfers			
Partnership Fee Timber	(119)	(113)	(538)
Funds Fee Timber	1,472	891	893
Total Combined Fee Timber	1,353	778	355
Timberland Management & Consulting	(1,305)	(730)	(681)
Real Estate	(48)	(48)	326
G&A	–	–	–
Total Intersegment Charges or Transfers	–	–	–
Total Operating Income (External)	2,913	1,279	689
Depreciation, Amortization and Depletion			
Partnership Fee Timber	2,883	2,413	2,381
Funds Fee Timber	2,534	–	1,341
Total Combined Fee Timber	5,417	2,413	3,722
Timberland Management & Consulting	3	17	127
Real Estate	240	190	684
G&A	151	191	156
Total Depreciation, Amortization and Depletion	5,811	2,811	4,689
Assets			
Partnership Fee Timber	54,990	57,982	59,911
Funds Fee Timber	146,803	89,531	55,836
Total Combined Fee Timber	201,793	147,513	115,747
Timberland Management & Consulting	10	38	54
Real Estate	31,757	30,604	28,752
G&A	2,277	8,925	20,858
Total Assets	235,837	187,080	165,411
Capital and Land Expenditures			
Partnership Fee Timber	524	532	1,795
Funds Fee Timber	58,311	34,553	269
Total Combined Fee Timber	58,835	35,085	2,064
Timberland Management & Consulting	2	–	3
Real Estate-development activities	1,075	1,639	3,451
Real Estate-other	185	537	-
G&A	125	23	552
Total Capital and Land Expenditures	60,222	37,284	6,070
Revenue by Product/Service			
Domestic forest products	18,384	12,016	17,698
Export forest products, indirect	9,290	2,831	3,426
Conservation easements and sales	2,400	3,298	3,736
Fees for service	31	632	944
Homes, lots, and undeveloped acreage	1,087	1,701	2,374
Total Revenue by Product/Service	31,192	20,478	28,178

13. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

(in thousands, except per unit amounts)	**Revenue**	**Income (Loss) from Operations**	**Net Income (Loss) Attributable to Unitholders**	**Earnings (Loss) Per Partnership Unit Basic**	**Earnings (Loss) Per Partnership Unit Diluted**
2010					
First quarter	**$5,966**	**$572**	**$451**	**$0.10**	**$0.10**
Second quarter	**8,089**	**131**	**(1,126)**	**(0.25)**	**(0.25)**
Third quarter	**8,591**	**889**	**1,050**	**0.23**	**0.22**
Fourth quarter	**8,546**	**1,321**	**1,663**	**0.35**	**0.35**
2009					
First quarter	$4,979	($41)	($123)	($0.03)	($0.03)
Second quarter	3,666	(724)	(693)	(0.16)	(0.16)
Third quarter	6,615	2,118	920	0.20	0.20
Fourth quarter	5,218	(74)	(376)	(0.08)	(0.08)

Quarterly fluctuations in data result from the addition and/or deferral of harvest volumes as well as the timing of real estate and CE sales, as disclosed in our quarterly filings. Management considered the disclosure requirements of Item 302(a)(3) and does not note any extraordinary, unusual, or infrequently occurring items except as disclosed.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Unitholders
Pope Resources, A Delaware Limited Partnership:

We have audited the accompanying consolidated balance sheets of Pope Resources, A Delaware Limited Partnership, and subsidiaries (collectively, the Partnership) as of December 31, 2010 and 2009, and the related consolidated statements of operations, partners' capital and comprehensive income (loss), and cash flows for each of the years in the three-year period ended December 31, 2010. These consolidated financial statements are the responsibility of the Partnership's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Pope Resources, A Delaware Limited Partnership, and subsidiaries as of December 31, 2010 and 2009, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2010, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Partnership's internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee for Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 9, 2011 expressed an unqualified opinion on the effectiveness of internal control over financial reporting.

/s/ KPMG LLP
Seattle, Washington
March 9, 2011

Report of Independent Registered Public Accounting Firm

The Board of Directors and Unitholders
Pope Resources, A Delaware Limited Partnership:

We have audited Pope Resources', A Delaware Limited Partnership (the Partnership), internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Partnership's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying "Management's Report on Internal Control Over Financial Reporting". Our responsibility is to express an opinion on the Partnership's internal control over financial reporting based on our audit.

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

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

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

In our opinion, Pope Resources, A Delaware Limited Partnership, maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Pope Resources, A Delaware Limited Partnership, and subsidiaries as of December 31, 2010 and 2009, and the related consolidated statements of operations, partners' capital and comprehensive income (loss), and cash flows for each of the years in the three-year period ended December 31, 2010, and our report dated March 9, 2011, expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP
Seattle, Washington
March 9, 2011

Results of Operations

(dollar amounts are in thousands, except per unit data)	***2010***	*2009*	*2008*	*2007*
Revenue				
Fee Timber	**$27,674**	$14,847	$23,551	$35,514
Timberland Management & Consulting	**31**	601	944	1,344
Real Estate	**3,487**	5,030	3,683	15,037
Total revenue	**31,192**	20,478	28,178	51,895
Operating income/(loss)				
Fee Timber	**9,703**	3,724	6,294	15,215
Timberland Management & Consulting	**(1,250)**	(375)	(543)	(883)
Real Estate	**(809)**	1,663	(1,111)	5,163
General & Administrative	**(4,731)**	(3,733)	(3,951)	(4,782)
Total operating income/(loss)	**2,913**	1,279	689	14,713
Depreciation, depletion, and amortization	**5,843**	2,811	4,689	5,549
Net interest expense/(income), excluding SLARS	**1,144**	1,007	225	(324)
Income tax expense/(benefit)	**(290)**	39	(61)	(69)
Debt extinguishment costs	**1,250**	1,137	–	–
SLARS impairment and loss or gain on dispositions	**(11)**	318	381	–
Noncontrolling interests	**(1,218)**	(950)	(1,018)	(402)
Net income/(loss)	**2,038**	(272)	1,162	15,508
PER DILUTED UNIT RESULTS				
Net income/(loss)	**$0.43**	($0.07)	$0.23	$3.22
Distributions	**0.70**	0.70	1.60	1.36
Partners' capital	**16.40**	18.17	18.83	20.48
Weighted average diluted units outstanding (000)	**4,578**	4,539	4,661	4,769
CASH FLOW				
Net cash provided by operating activities	**$8,950**	$662	$3,952	$12,113
Distributions to unitholders	**3,241**	3,219	7,444	6,449
Unit repurchases	**12,267**	1,838	3,940	1,374
Payment/(issuance) of long-term debt, excluding debt-issuance costs	**(21,008)**	97	1,342	1,481
Free cash flow # *	**4,894**	(1,615)	1,957	11,268
FINANCIAL POSITION				
Land and timber, net of depletion	**$226,678**	$171,401	$137,133	$138,112
Total assets	**235,837**	187,080	165,411	179,325
Long-term debt, including current portion	**50,498**	29,490	29,586	30,727
Partners' capital	**70,990**	83,126	87,817	96,644
FINANCIAL RATIOS#				
Total Debt to Total Capitalization	**36%**	26%	25%	24%
Return on Equity	**3%**	0%	1%	17%
Enterprise value / EBITDDA	**30**	50	33	11
UNIT TRADING PRICES#				
High	**$38.61**	$28.98	$43.81	$50.01
Low	**23.32**	15.61	15.00	34.25
Year-end close	**36.80**	24.60	20.00	42.75
Market capitalization (year end – $millions)	**159**	113	93	202
Enterprise value (year end – $millions)	**315**	206	149	245
Fee timber harvest (MMBF)	**53**	32	38	55
Average per MBF log revenue	**486**	410	506	607
Employees at December 31 (full time equivalent) #	**45**	42	51	58

Footnotes

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

 # Unaudited

2006	2005	2004	2003	2002	2001	2000
$35,260	$44,424	$33,571	$22,916	$23,298	$24,999	$21,444
3,670	7,764	1,601	2,386	7,295	9,703	11,011
27,320	4,818	4,476	1,734	1,599	13,143	18,202
66,250	57,006	39,648	27,036	32,192	47,845	50,657
14,592	16,320	15,126	9,669	10,199	9,190	12,113
1,266	3,540	(598)	272	919	1,685	152
13,864	1,270	1,586	(476)	(1,667)	(2,709)	(10,888)
(3,817)	(3,651)	(2,986)	(2,842)	(3,864)	(5,110)	(7,254)
25,905	17,479	13,128	6,623	5,587	3,056	(5,877)
7,017	11,252	5,752	3,546	3,864	7,698	2,899
625	2,477	2,952	2,806	2,894	2,961	700
439	997	–	242	(788)	356	(326)
–	–	–	–	–	–	–
–	–	–	–	–	–	–
(69)	321	–	47	147	171	–
24,910	13,684	10,176	3,528	3,334	(432)	(6,251)
$5.22	$2.88	$2.22	$0.78	$0.74	($0.10)	($1.38)
1.06	0.80	0.44	0.24	0.10	–	0.40
18.70	14.29	12.01	10.19	9.65	8.98	9.12
4,762	4,753	4,594	4,522	4,520	4,526	4,528
$33,114	$23,950	$16,485	$8,029	$8,900	$11,235	$9,362
4,961	3,701	1,989	1,084	452	–	1,811
–	–	–	–	–	–	–
1,675	1,883	1,979	1,662	1,110	(26,540)	424
25,784	16,731	10,898	3,595	4,119	2,588	(6,603)
$133,731	$78,222	$87,517	$69,003	$70,495	$71,549	$25,411
180,282	106,358	94,868	86,308	86,788	84,187	60,857
32,208	33,883	35,766	37,745	39,239	39,667	13,127
87,605	66,405	54,533	46,036	43,598	40,673	41,280
27%	34%	40%	45%	47%	49%	24%
32%	23%	20%	8%	8%	-1%	-14%
6	5	7	9	10	10	(43)
$36.00	$56.85	$25.25	$15.99	$15.50	$24.50	$25.75
30.00	19.35	15.00	7.00	9.30	14.00	18.88
34.32	31.02	25.00	15.43	10.11	14.75	24.50
161	144	113	70	46	67	111
208	160	149	97	78	106	114
55	74	60	45	45	36	37
611	576	529	476	488	503	549
60	65	49	48	79	123	241

Definitions

Free cash flow = net income plus depreciation, depletion, amortization, and cost of land sold less principal payments and capital expenditures excluding timberland acquisitions

Enterprise value = market capitalization less cash plus both total debt outstanding and noncontrolling interests

Unitholder Information

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President and Vice Chairman, Retired
Wright Runstad & Company
Seattle, Washington

David L. Nunes
President and Chief Executive Officer
Pope Resources
Poulsbo, Washington

Peter T. Pope
Manager
PT Pope Properties LLC
Portland, Oregon

J. Thurston Roach
Private Investor
Seattle, Washington

Officers

David L. Nunes
President and Chief Executive Officer

Thomas M. Ringo
Vice President and Chief Financial Officer

STOCK EXCHANGE LISTING

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

INVESTOR CONTACT

Any questions or information requests can be referred to:

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Vice President and Chief Financial Officer

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UNIT TRANSFER AGENT AND REGISTRAR

BNY Mellon Shareowner Services
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877-255-0989
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ANNUAL MEETING

No annual meeting is required for the partnership.

FORM 10-K

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

Pope Resources
Investor Relations Department
19245 10th Avenue NE
Poulsbo, WA 98370

INDEPENDENT ACCOUNTANTS

KPMG LLP

801 Second Avenue, Suite 900
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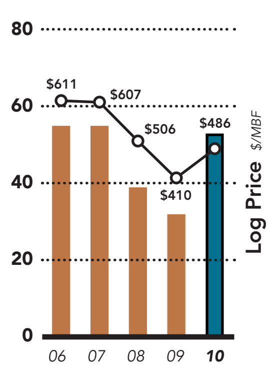
pope resources 19245 10th Avenue NE Poulsbo, WA 98370 | www.poperesources.com

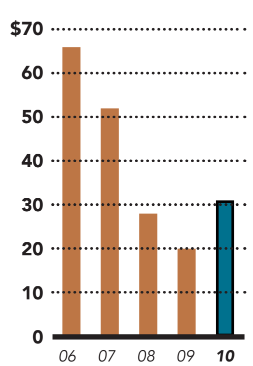
financial highlights

(thousands, except per unit data)	**2010**	2009	2008
Revenue			
Fee Timber	**$27,674**	$14,847	$23,551
Timberland Management & Consulting	**31**	601	944
Real Estate	**3,487**	5,030	3,683
Total revenue	**$31,192**	$20,478	$28,178
Income/(loss) from operations			
Fee Timber	**$9,703**	$3,724	$6,294
Timberland Management & Consulting	**(1,250)**	(375)	(543)
Real Estate	**(809)**	1,663	(1,111)
Administrative	**(4,731)**	(3,733)	(3,951)
Total income from operations	**$2,913**	$1,279	$689
Net income	**$2,038**	($272)	$1,162
Net income per fully diluted unit	**$0.43**	($0.07)	$0.23
Net cash provided by operating activities	**$8,950**	$662	$3,952
Free cash flow	**$4,894**	($1,615)	$1,957
Free cash flow per fully diluted unit	**$1.07**	($0.36)	$0.42
Unit price at year-end	**$36.80**	$24.60	$20.00
Distribution per unit	**$0.70**	$0.70	$1.60
Units outstanding at year-end per Nasdaq	**4,328**	4,576	4,665
Total assets	**$235,837**	$187,056	$165,411
Long-term debt, including current portion	**50,498**	29,490	29,586
Noncontrolling interests	**107,817**	70,931	44,354
Partners' capital	**70,990**	83,126	87,817
Partners' capital per unit	**$16.40**	$18.17	$18.83
Fee timber harvest (MMBF)	**53**	32	38

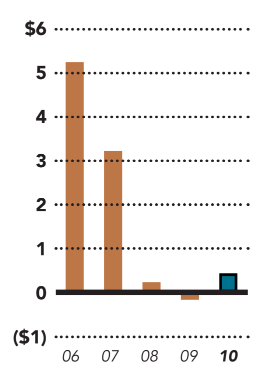
Harvest Volume
MMBF



Total Revenue
millions



Earnings Per Diluted Unit



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UNIT TRANSFER AGENT AND REGISTRAR

BNY Mellon Shareowner Services
480 Washington Boulevard
Jersey City, NJ 07310-1900
877-255-0989
www.bnymellon.com/shareowner/isd

ANNUAL MEETING

No annual meeting is required for the partnership.

FORM 10-K

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

Pope Resources
Investor Relations Department
19245 10th Avenue NE
Poulsbo, WA 98370

INDEPENDENT ACCOUNTANTS

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801 Second Avenue, Suite 900
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