Pope Resources

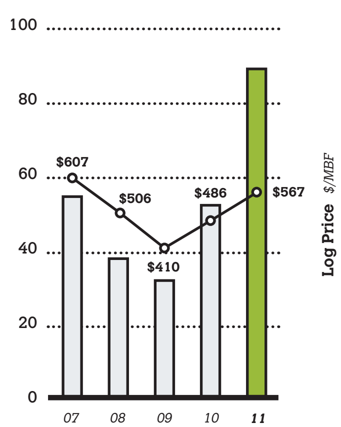
2011 ANNUAL REPORT

Financial Highlights

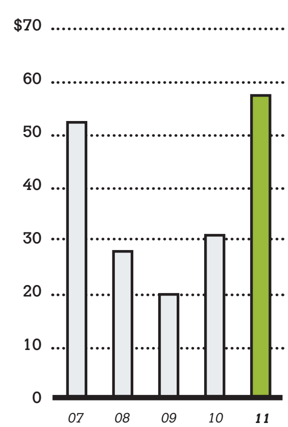
(thousands, except per unit data)	2011	2010	2009
Revenue			
Fee Timber	$52,729	$27,674	$14,847
Timberland Management & Consulting	–	31	601
Real Estate	4,545	3,487	5,030
Total revenue	$57,274	$31,192	$20,478
Income (loss) from operations			
Fee Timber	$16,899	$9,703	$3,724
Timberland Management & Consulting	(1,515)	(1,250)	(375)
Real Estate	(349)	(809)	1,663
Administrative	(4,188)	(4,731)	(3,733)
Total income from operations	$10,847	$2,913	$1,279
Net income (loss)	$8,754	$2,038	($272)
Net income (loss) per fully diluted unit	$1.94	$0.43	($0.07)
Free cash flow*	$18,641	$4,894	($1,615)
Free cash flow per fully diluted unit*	$4.31	$1.07	($0.36)
Unit price at year-end	$42.99	$36.80	$24.60
Distribution per unit	$1.20	$0.70	$0.70
Units outstanding at year-end per Nasdaq	4,388	4,328	4,576
Total assets	$230,408	$235,837	$187,056
Long-term debt, including current portion	45,825	50,498	29,490
Noncontrolling interests	101,399	107,817	70,931
Partners' capital	75,759	70,990	83,126
Partners' capital per unit	$17.27	$16.40	$18.17
Fee timber harvest (MMBF)	90	53	32

**Unaudited*

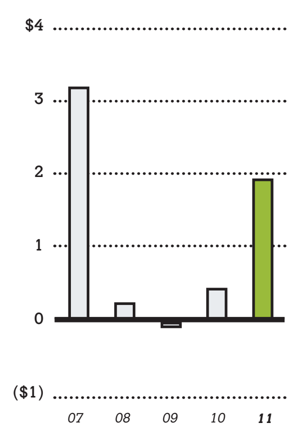
Harvest Volume
MMBF



Total Revenue
millions



Earnings Per Diluted Unit



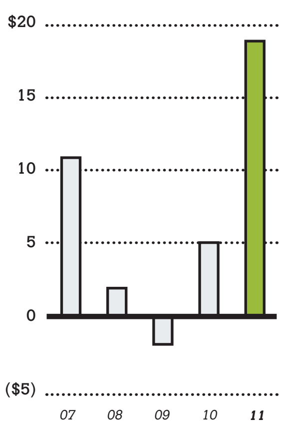
David L. Nunes
President and
Chief Executive Officer

Dear Fellow Unitholders,

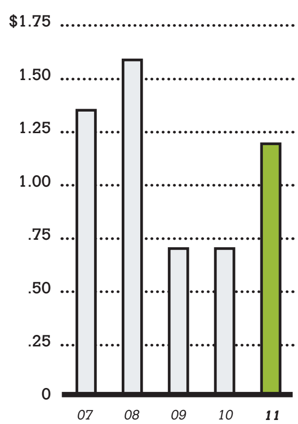
One of the key ways we compete as a small company is by being nimble. An aspect of this nimbleness entails extensive planning and the development of relationships with customers and contractors to give us the best chance of being prepared to capitalize on changing market conditions. This past year represented a textbook case of the value of such preparation. We recognized in late 2010 that the log export market to China was going to continue to strengthen from its explosive growth earlier that year. With over 50 million board feet (MMBF) of deferred harvest volume accumulated by the end of 2010 during the preceding two years of recession and a considerable number of permitted harvest units, we were well positioned to take advantage of this growing market. We are also blessed with a high proportion of low elevation timberlands that allow for winter logging. So we made early commitments to logging contractors and started 2011 aggressively. With a strong beginning and end of the year, when most of our competitors had more limited seasonal operating capabilities, our 2011 harvest volume surged 70% over 2010's level to 90 MMBF.

Our Real Estate segment also made significant contributions, despite continued weakness in the market for developable land, with two conservation related sales propelling growth in segment revenues to $4.5 million. Lastly, our timber fund business continues to gain momentum with increased harvest volume from the 61,000 acres under management in our first two funds. With all cylinders of our enterprise's economic engine working in unison, our revenue nearly doubled to $57 million and our net income attributable to unitholders increased over four-fold to $8.8 million, or $1.94 per diluted ownership unit. So, while the overall economy continues to limp along and the recovery in U.S. housing starts continues to

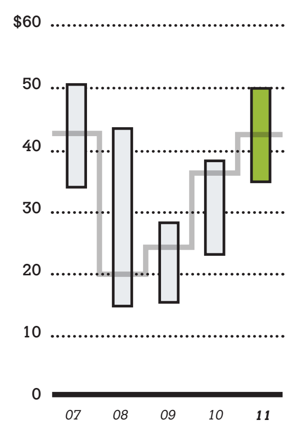
Free Cash Flow
millions



Distribution Per Unit



Unit Trading Range
close



be pushed further and further out, we enjoyed our strongest year since 2007.

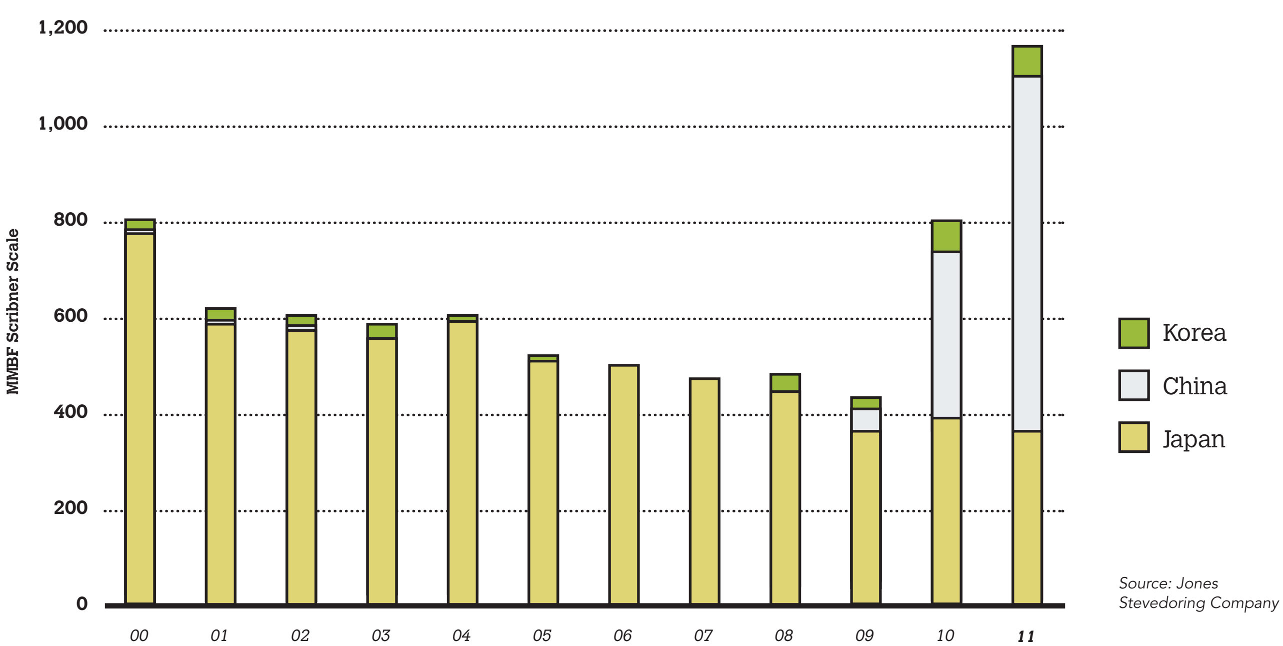
As heartened as we are about the significant improvement in our 2011 bottom line results, we are also excited about the progress we made on many of the initiatives underway that we expect to add value to our assets and contribute to future growth in earnings and cash flow. The balance of this letter will take a closer look at the strategies within each of our segments, along with a discussion of our capital allocation priorities and our perspective on future market conditions.

China Market Propels Fee Timber Segment to Record Harvest Level

The big story this past year for our Fee Timber segment was the export market to China. After years of little to no log import volume from the Pacific Northwest (PNW), China resumed buying logs in 2009. This trading activity was a byproduct of inadequate infrastructure in Russia, historically China's largest supplier of forest products, and a new 25% Russian log export tariff. While Russia remains the largest supplier of logs and lumber to China, the combination of the new tariff and a significant increase in demand from China associated with its 2010 GDP growth of 10% resulted in increases in market share from suppliers throughout the Pacific Rim. By the third quarter of 2010, China surpassed Japan as the largest buyer of logs from the PNW. As the Chinese economy expanded in 2010, it also resulted in significant increases in lumber exports from the PNW, which benefited our domestic log customers and strengthened their ability to compete for our logs.

In the first half of 2011, this momentum continued for both log and lumber export markets. Chinese markets provided a much needed relief valve for soft markets in the U.S. as a result of depressed housing starts. British Columbia shipped over 3 billion board feet of lumber to China in 2011, which helped mitigate downward pressure on lumber prices associated with U.S. housing starts. From a log export perspective, the Chinese market was buying a log quality mix that would have otherwise been targeted at the U.S. domestic market. This translated to volume being harvested that would have otherwise

Washington, Oregon, California Breakbulk Log Exports to Asia



Source: Jones Stevedoring Company

been left "on the stump" to continue to grow. As of year-end 2010, it has been estimated that roughly a year's worth of harvest had been deferred collectively by PNW timberland owners due to depressed U.S. housing starts. With the re-emergence of the China export market, suppliers such as Pope Resources were able to dip into this "banked" harvest volume and resume higher levels of log production.

Since China uses solid wood in relatively low valued end-use applications such as concrete forms, furring strips for walls and floors, and packaging, this market is less particular about species. This usage pattern translates to relatively strong demand for lower quality whitewood species from the PNW. As a result, we experienced a compression in the customary price spread between more valuable Douglas-fir and less valuable whitewoods.

We responded to these changing market dynamics in a number of ways. We started the year aggressively by making commitments to logging contractors and commencing our logging activity earlier than normal. As mentioned above, we are fortunate to have a large proportion of our ownership at lower elevations that allows for winter logging. While many of our competitors have to wait for the snow pack to melt in order to start logging, we are typically able to log throughout the winter months on large portions of our timberlands. We moved planned harvest units forward within the year and increased our annual target volume by dipping into our considerable balance of deferred volume. Where possible, we also shifted to harvest units with a heavier mix of whitewoods. In the summer months, we added harvest units from some of our steeper ground that requires more expensive cable logging systems. Many of these harvest units had been deferred due to low residual stumpage values during the depths of the 2008-to-2010 market downturn.

The net effect of all these changes was a record (for us) annual harvest level of 90 MMBF in 2011. We would not have been able to achieve this without the considerable preparation carried out during the lean years of 2008 to 2010, when we increased the number of permitted harvest units in anticipation of improving future market conditions, while at the same time deferring harvest volume in light of then-prevailing market conditions. We also benefited from the 37,000 acres acquired on behalf of our second private equity timber fund, ORM Timber Fund II (Fund II), in 2009 and 2010, which contributed 27 MMBF, or 30%, to the 90 MMBF 2011 harvest. With the surge in the export market to China, we saw our export mix increase to a high-water mark of 45% in 2011, facilitated by the fact that all eight of our tree farms are tributary to log export facilities in Washington and Oregon.

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In addition to the strong direct impact of a resurgent Chinese log export market, we enjoyed indirect benefits through a robust Chinese lumber export market. Most of our major domestic sawmill customers took advantage of this dynamic by shipping significant volumes of lumber to China, which in turn allowed these mills to pay a higher price for logs than would have otherwise been the case. The combination of these direct and indirect Chinese market influences translated to a 17% increase in our average realized log price, which increased from $486/MBF in 2010 to $567/MBF in 2011. While this represents a significant improvement in pricing, it is made all the more impressive by the fact that in 2011 20% of our harvest volume came from lower-valued whitewood species, as compared to only 13% in 2010. This stronger log pricing environment in 2011 contributed to our decision to dip into our deferred harvest volume, as well as underscoring the benefit of our prior decisions to preserve value "on the stump" between 2008 and 2010. The combination of the biological growth rates of our merchantable timber, which average 4.0% per year, and the recovery in log prices, which have increased 38% over average realized prices in 2009, easily overcome any investment hurdle rate applied to such deferral decisions. While dipping into our deferred volume in 2011, we nevertheless ended the year with 34 MMBF of cumulative deferred volume. We will continue to look for opportunities to reduce this deferred harvest volume by adding incremental harvest units when market conditions are favorable and operational considerations permit.

Timber Fund Business Continues to Gain Momentum

Following the third quarter 2010 acquisitions of two tree farms totaling 25,000 acres on behalf of Fund II, we concluded the drawdown period for this fund in early 2011. Including our first fund, ORM Timber Fund I (Fund I), we have acquired on behalf of our various fund investors a total of 61,000 acres of commercial timberlands, with three tree farms each in western Washington and Oregon, for a total acquisition value of $150 million.

By being in the timber fund business, we are able to attract and hire talent that would be difficult to justify for the stand-alone assets of either Pope Resources or the funds.

Pope Resources benefits in numerous ways from the growth in this fund business. First, we are putting capital to work in growing our asset base. The co-investments we make in our timber funds, which total over $28 million in our first two funds, represent the company's primary investment growth vehicle. This co-investment capital, primarily from real estate sales in 2006 and 2007, generated a 2011 cash-on-cash yield of $1.7 million, or 5.9%, through distributions paid to fund investors. These fund distributions, in turn, indirectly supported nearly one-third of the quarterly distributions paid to Pope Resources' unitholders. Expansion of the timber fund business and the anticipated resultant increase in the distributions from our co-investments will help support continued growth in Pope Resources' quarterly distributions.

The timber fund business also benefits Pope Resources by generating fee income, including an annual asset management fee, timberland management fees, and log marketing fees. In 2011, these fees totaled $2.4 million. Our timber fund business has now reached a sufficient critical mass to cover, through the fees generated, our direct variable costs for managing the funds as well as a large proportion of allocated costs that are shared across all our tree farms. By being in the timber fund business, we are able to attract and hire talent that would be difficult to justify for the stand-alone assets of either Pope Resources or the funds. So both timberland ownerships, Pope Resources and the funds, benefit from these additional economies of scale. Lastly, if the funds achieve threshold return levels, Pope Resources will benefit from carried interest incentive payments. Such incentive payments, if earned, will take place at the end of each fund's 10-year investment term.

In 2011, we launched the marketing of our third fund, ORM Timber Fund III (Fund III), which has a targeted size of $100 million. In the fourth quarter, we completed our first closing for $51 million, and expect to have the final closing in this fund by mid-2012. As Pope Resources has less available cash on hand relative to the period when we were raising capital for the first two funds, our co-investment in Fund III will be lower than the 20% co-investment in the first two funds. Depending on the size of the final capital commitments made by our investors, we expect our co-investment in this fund to be between 5% and 10% of the total capital raised. With our first closing in Fund III, we are now actively in the market looking for timberland properties to include in this portfolio. We have a three-year drawdown period within which to place the capital raised in this fund.

Real Estate Focus on Conservation Related Sales and Downstream Value Creation

With real estate markets remaining depressed since 2008, we have relied heavily on conservation-related sales to generate revenue. This past year was no exception. In 2011, we completed a $2.0 million conservation sale with The Nature Conservancy on a 386-acre portion of our Dabob Bay ownership. We also closed on a $0.5 million conservation easement with Forterra (formerly Cascade Land Conservancy) on 255 acres adjacent to a conservation easement we sold in 2009. Since 2008, we have closed on a combined total of $12.1 million of conservation sales and conservation easements, providing protections on over 18,000 acres. What distinguishes these conservation sales from garden-variety rural land sales is that the buyer has a specific objective to protect sensitive wildlife habitat, provide for added watershed protection, and/or preserve recreational uses. Conservation easement sales typically involve our selling downstream development rights while preserving the ability to practice forestry and retaining fee simple ownership of the land. Both types of conservation sales typically take a few years to complete and often involve complicated funding mechanisms. We embraced these complexities years ago as a means of diversifying our revenue stream. Every year we assist conservation groups with their grant applications, and as a result, conservation related sales have become a fairly steady source of revenue. This strategy has been particularly helpful during the real estate downturn.

Notwithstanding the current state of U.S. housing starts and the broader housing market, we continue to work diligently to add value to our 2,800-acre Real Estate portfolio. Much of our work is focused on capitalizing on two trends we have observed in the homebuilding sector. First, during the early stages of the housing downturn, builders cut staff associated with permitting new lot inventory. These builders have worked off of existing inventory and focused on acquiring distressed projects and properties. Second, we have seen considerable elimination of local and regional builders along with an influx of national builders and developers, many of whom have expressed interest in purchasing fully developed lots. We are working to position ourselves to have lots ready to market when homebuilding improves and builders have worked through much of their distressed inventory. We believe the combination of these forces will particularly improve the attractiveness of our projects in Gig Harbor and Kingston, which now contain over 1,500 entitled lots.

As detailed in our 2010 annual report, we received preliminary plat approval in early 2011 and entered into a 20-year development agreement for our 244-acre Harbor Hill project in Gig Harbor, a suburb of Tacoma. Following sales in 2006 and 2007 for a YMCA, a Costco Wholesale store, and surrounding retail pads, this project was in the enviable position of being cash flow positive ahead of its first residential sale while having significant sewer, water, and road infrastructure already constructed. Today, this project consists of a 16-acre retail site, 28 acres of business park lots, and 200 acres of residential land entitled for 554 single-family lots and 270 multi-family units. With its many existing amenities and key infrastructure already constructed, we believe this project will be particularly attractive as many builders are focused on better locations clustered near key employment centers with long established amenities and infrastructure. Our current focus is on marketing the multi-family portion of this project, as this sector of the home building market is more active than the single-family sector. We are under contract to sell roughly half the multi-family land, with the closing expected this year provided our customer receives its required building approvals.

Consistent with our mission of maximizing value for our land assets, we are under contract to sell our company headquarters building along with the surrounding land to Safeway for a new grocery store. If Safeway receives all its required building approvals, this transaction will close this year. During 2011, we purchased a 29,000 square foot office building in Poulsbo for $3.2 million from the FDIC. This building was owned by a failed regional bank, and the entire building is currently under a long-term lease with a new bank that acquired the assets of the failed bank. Assuming our transaction with Safeway is consummated, we intend to renegotiate the lease with this new bank in order to occupy roughly one-third of the building. If the Safeway transaction does not close, we will stay in our current building and hold the bank building as an investment property. We acquired this building in a tax-efficient manner by employing a reverse tax-deferred exchange that involved the aforementioned conservation sale and two smaller land transactions, thus deferring a significant amount of capital gains tax liability which otherwise would have flowed through to our unitholders. If the Safeway transaction is completed and we relocate our office, we will have significantly reduced our net occupancy cost, while also providing for some needed expansion capacity.

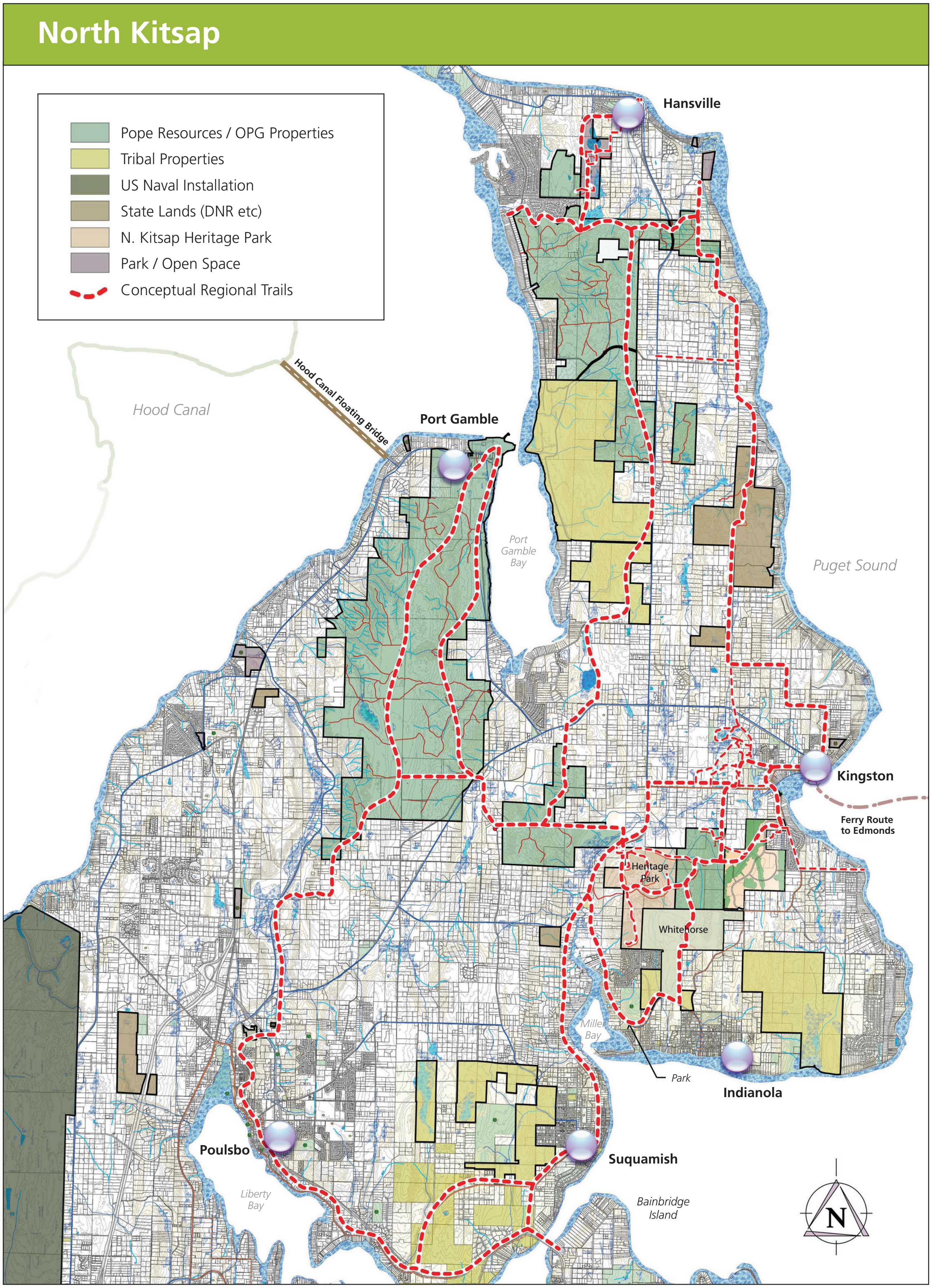
Pivotal Year Ahead for Port Gamble and North Kitsap Lands

Pope Resources owns approximately 8,000 acres of land in north Kitsap County. These holdings include our Arborwood project in Kingston which contains 751 residential units, the town of Port Gamble, two miles of undeveloped shoreline divided into 26 20-acre lots, and approximately 7,300 acres of commercial timberland subdivided into 340 undeveloped lots. In 2007, we embarked on a process to develop an exit strategy from the majority of these timberland holdings. These lands are concentrated south of the historic company town of Port Gamble, and include parcels further east towards Kingston and to the north on the Hansville peninsula (see map, opposite page). Over time, it has become increasingly clear that these lands are not well-suited to a long-term timberland management strategy as surrounding populations continue to expand. North Kitsap includes over 80,000 residents, a number that will only grow over time as population pressures push toward west Puget Sound.

These timberlands are used extensively for recreation, not only by existing neighbors, but also the broader Kitsap County and Puget Sound populations. When our foresters are out on these lands, it is rare not to run into multiple groups recreating on horseback, mountain bike, or on foot. We estimate that tens of thousands of people use these lands every year for recreation. In our early planning efforts, we wanted to develop an exit strategy that preserved this recreational asset. In that spirit, we developed a concept called the "String of Pearls" which linked the different population centers across the north part of the County with a land and water trail network. As part of this concept, we helped organize the North Kitsap Trails Association (NKTA), a non-profit whose mission is to preserve and promote the use of the many existing trails and logging roads used by individuals throughout the region as well as to create new trails. The NKTA, with the help of a National Park Service grant and a substantial number of volunteer hours, developed a trails plan that was approved by the County Commissioners in late 2011 (the trail plan can be viewed at http://www.northkitsaptrails.org/files/NKTA_TrailPlan_111128.pdf).

In 2010, we worked with the County to develop a plan to transfer residential density from portions of the surrounding 7,000 acres and concentrate that density inside and around the town of Port Gamble. This plan to transfer development rights was designed to provide for more efficient delivery of residential services while at the same time lower the value of the surrounding lands to facilitate purchase by the County in order to preserve wildlife habitat and existing recreational use. This original plan, unfortunately, was abandoned after vehement opposition from the nearby Port Gamble S'Klallam tribe, which was opposed to more development around the town of Port Gamble and the potential this could create for contamination of Port Gamble Bay.

Following this setback, we entered into an 18-month option agreement with Forterra to give it the exclusive right to acquire most of these 7,000 acres. The option agreement, signed in September 2011, divides the land into five logical sale tracts. If its capital raising efforts are successful, Forterra will have the ability to acquire as many of these tracts of timberland as it has capital to spend. We are working to promote this option agreement with the Kitsap Forest and Bay Coalition (http://greatkitsapforestbay.org), a group that includes Forterra, Kitsap County, two local Native American tribes, and other



North Kitsap
Pope Resources / OPG Properties
Tribal Properties
US Naval Installation
State Lands (DNR etc)
N. Kitsap Heritage Park
Park / Open Space
Conceptual Regional Trails
Hansville
Hood Canal
Hood Canal Floating Bridge
Port Gamble
Port Gamble Bay
Puget Sound
Kingston
Ferry Route to Edmonds
Heritage Park
Whitehorse
Miller Bay
Park
Indianola
Poulsbo
Suquamish
Liberty Bay
Bainbridge Island
N

conservation groups. The option agreement has provisions for extending the March 2013 term if Forterra has applied for grant applications and is still awaiting final awards. Otherwise, the option will expire and we will look to other means for selling these lands. This could range from finding a bulk buyer to selling individual rural residential lots.

In addition to work supporting the Forterra option, we are preparing to submit to the County a development plan for the town of Port Gamble. This project submission will entail redevelopment of the town and former millsite consistent with the town's underlying zoning, which calls for approximately 300 residential units, waterfront retail and hotel, and new office uses. A key foundation for this plan is the completion of the environmental cleanup efforts that have been underway since 2002. In concert with the Washington State Department of Ecology (DOE), we expect to have a final Clean-Up Action Plan approved this year. This plan will detail the nature and timing of the remaining cleanup efforts needed to comply with DOE regulations. It is our expectation that a year from now we will have a much clearer picture of the future for both the town and its surrounding timberlands.

In our fund business, we have placed more than $28 million of co-investment capital over the past five years translating to a 20% stake in a well-diversified 61,000-acre timberland portfolio.

Capital Allocation Continues to Stress Fund Co-investment and Growth in Distributions

Our capital allocation priorities strive for balance between growing the company, providing liquidity to unitholders, and retaining the flexibility to be opportunistic when attractive investment alternatives present themselves. Looking back over the past number of years, we believe we have struck the appropriate balance.

In our fund business, we have placed more than $28 million of co-investment capital over the past five years translating to a 20% stake in a well-diversified 61,000-acre timberland portfolio in Washington and Oregon that we expect will continue to deliver attractive cash and capital appreciation yield over the remaining term of each fund. As described earlier, much of this co-investment capital was generated from large real estate sales in 2006 and 2007. Given the decline in our cash flow associated with the housing downturn, we have intentionally kept our co-investment in Fund III at a more modest level. By the time of Fund III's anticipated final closing this summer, we expect to co-invest no more than $7.5 million, which will represent between 5% and 10% of that fund's equity. We plan to fund this co-investment capital over Fund III's three-year drawdown period through a combination of anticipated real estate sales, timber harvest cash flows, distributions from our current co-investments in Fund I and Fund II, and our existing operating line of credit.

We have always resisted the temptation to be overly formulaic with respect to our distribution policy. We have also been fairly decisive in reducing our distribution during lean years, as we did twice in 2009 during the depths of the recession. The quarterly distribution was increased in the third quarter of both 2010 and 2011 in response to improving market conditions and increases in cash flow. In 2010, we introduced a new metric, adjusted cash available for distribution (ACAD), as one of the measures we use in setting our quarterly distribution level. ACAD is defined as cash flow from operations plus financed debt extinguishment costs, less maintenance capital expenditures and required principal payments on debt. Our distribution payout as a percent of ACAD was 42% for 2010 and 37% for 2011. So while our annual distribution per unit increased by 71% in 2011, the payout ratio actually decreased slightly as a result of increased cash flow in 2011. Our payout ratio is currently set fairly conservatively as we are taking a "wait and see" approach with respect to the broader economic recovery. If we continue to see gradual improvement in housing starts that translates into healthy harvest levels, then we should be well-positioned to continue to increase our quarterly distribution.

As detailed in last year's letter, we were fortunate to be in a position to repurchase a large block of our units at the end of 2010 that represented 7.2% of total units outstanding at that time. While we have had a unit repurchase program in place for several years, we have been fairly cautious in setting prices and amounts to be repurchased. We viewed this late-2010 repurchase opportunistically as we had sufficient confidence that the market momentum we were experiencing in the second half of 2010 would continue into 2011. So we tapped our operating line of credit by borrowing $9.6 million in late 2010 to complete this repurchase transaction, knowing that the foregone quarterly distributions on repurchased (and retired) units would more than cover the incremental interest expense. At the time, we thought it would take up to two years to pay down this debt. With strong market conditions and higher than expected harvest levels in 2011, we were able to pay down $4.6 million of this debt last year. So with anticipated real estate sales and harvest levels in 2012, we anticipate being able to pay off this line of credit balance this year.

The aforementioned purchase of the Poulsbo office building is another example of an opportunistic deployment of capital. While we would have preferred to look for replacement office space once we were certain that Safeway's acquisition of our existing office building would close, we felt this was an opportunity too good to pass up. As described earlier, we feel our financial risk is manageable as the building is fully leased for the next four years. So we expect to either be in a new office space by the end of this year, having completed the successful sale of our existing building, or have an extra investment property in our Real Estate portfolio.

On the heels of 2011's strong performance, we are bullish on our future ability to generate cash flow. This optimism is fueled by the availability of prior harvest deferrals, growth in our timber fund business, and anticipated real estate sales that we have been working on for a number of years. As stated earlier, we will allocate capital to create a balance between timber fund co-investments that grow our asset base, providing greater liquidity to unitholders in the form of higher quarterly distributions, and retaining the flexibility to pursue opportunistic investments.

Future Outlook Positive if Somewhat Cautious Heading into 2012

We enter 2012 with a more cautious outlook than we did a year ago. Part of this wariness relates to cooling of the Chinese economy. Beginning in the third quarter, markets in China for PNW logs and lumber cooled down from the torrid pace experienced in the second quarter. Construction markets in that country became overbuilt, housing inflation soared, and the government placed restrictions on credit to try to slow down the economy. As a result, log and lumber inventory levels swelled in Chinese ports during the second half of 2011. Fourth quarter volumes fell further in an effort to bring the market into balance. We have seen some recovery in volume flows during the first quarter of 2012, but with softer pricing. The species price compression we experienced last year has relaxed somewhat, with prices for whitewood export logs falling relative to Douglas-fir. So we are starting off the year at a much more restrained harvest pace relative to 2011.

As we look to 2012, we see another strong year, but perhaps with a slightly lower total harvest level. We are preparing to harvest between 75 and 85 MMBF depending on how markets unfold for the balance of the year. With our strong balance sheet, we have significant flexibility to defer more harvest if need be. We will continue to prepare for multiple market scenarios, and with 34 MMBF of deferred harvest volume, have significant flexibility to increase harvest levels if markets take off like they did last year.

While the China market has cooled somewhat, we still view it as an important long-term market. Although the Russian tariff is expected to be reduced with their admittance into the WTO, we do not see Russia returning to the type of market share it enjoyed five years ago. It simply does not have sufficient infrastructure in place to supply the growing market in China. We see a continued significant presence for PNW suppliers in the years to come and believe China will continue to serve as an important market outlet as U.S. housing starts will likely take a few more years to break through the one million starts level.

Looking further downstream, we see more upside should we get the convergence of a recovery in U.S. housing starts at the same time as a shrinking of supply from mountain pine beetle infested forests in interior British Columbia and continued strength in Asian export markets. Some are referring to this as an impending "super cycle." We will certainly prepare for such a potentiality in the next five years, but will take a cautious approach in the near term.

At the beginning of this year, I marked my 10th anniversary as CEO of Pope Resources. As I look back, I am very appreciative of the opportunity to lead this fine organization and proud of the team we have assembled and the many accomplishments we have enjoyed. We weathered some pretty tough times during this recent recession and emerged well-positioned to capitalize on future market opportunities. I am excited about this company's future prospects and look forward to working with our Board of Directors, management team, and employees to continue adding value to our assets. Lastly, I would like to thank you, our unitholders, for your continued faith in our team and our strategies. As always, I welcome your feedback and questions.

David L. Nunes
President and CEO
February 29, 2012

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 2011 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 both domestically and overseas, particularly in certain parts of Asia; 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; the impacts of climate change and natural disasters on our timberlands and on surrounding areas; and the potential impacts of fluctuations in foreign currency rates as they affect demand for our products and customers' ability to pay. 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 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 segment 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 selling 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, and will not recognize operating income until that project is sold. In addition, within this segment we sometimes negotiate and sell conservation easements (CE's) on Fee Timber properties to preclude future development. Our third business segment, which we refer to as Timberland Management & Consulting ("TM&C"), is raising and investing capital from third parties for private equity timber funds, and thereafter managing those funds for the benefit of all investors.

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 co-investment, into new timberland properties. We have raised two timber funds that have acquired a combined $150 million of timberland properties. Our 20% co-investment in the first two Funds, which totals $28 million, affords us a share of the Funds' distributed 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. We believe our co-investment strategy also boosts our credibility with existing and prospective investors by demonstrating that we have both an operational as well as a financial commitment to the Funds' successes. We are in the process of raising a third fund with a target total Fund III size of $100 million. To date, we have closed on $51 million of committed capital for Fund III, $7 million of which represents our co-investment. The Funds are consolidated into our financial statements, with the income attributable to equity owned by third parties reflected in our Consolidated Statement of Operations under the caption "Net (income) loss attributable to noncontrolling interest-ORM Timber Funds."

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 in each market 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 or quarterly 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 even less volatile, with pricing changes that lag behind both lumber and log markets. This is largely 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 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 with 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.

Land held for sale in western Washington by our Real Estate segment is suitable primarily for residential and commercial building sites. The markets for these products have recently suffered along with regional and national markets, producing a decline in our sales. The challenges of our Real Estate segment 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 revenue, net income and cash flows increased in 2011 from 2010 and 2009 primarily as a result of increased demand for logs in China. Markets for logs in Japan and Korea were stable for most of this period, with renewed strength in late 2011 from Japan. 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 exceedingly low housing starts in 2009, 2010 and 2011, which negatively impacted our revenues, net income and cash flow. While these macroeconomic factors did not materially improve in 2011, their impact in 2011 on our business was overshadowed by the strength of log export markets.

Currency exchange rates and ocean freight 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. We sell our export logs 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 2011, the U.S. dollar weakened against the Canadian, Australian and New Zealand dollars, the Japanese yen and Korean won, and Russian ruble. This relative currency weakness increased the attractiveness of our logs to Asian markets.

Our consolidated revenue in 2011, 2010, and 2009, on a percentage basis by segment, was as follows:

Segment	2011	2010	2009
Fee Timber	92%	89%	72%
Timberland Management & Consulting	–%	–%	3%
Real Estate	8%	11%	25%

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

Outlook

Remaining harvest volume deferred from prior years totaled 34 MMBF as of December 31, 2011 and provides us the flexibility to respond to strength in log markets by increasing our harvest level above our current planned harvest level for 2012 of 75-85 MMBF, which includes 28 MMBF from the Funds. Export log markets are expected to provide continued price support until the domestic market recovers. Log markets in early 2012 have slowed compared to the demand seen in the fourth quarter of 2011, but are showing signs of improvement.

We expect some improvement in operating results for our Real Estate segment with anticipated closings of properties in 2012.

General & Administrative costs in 2012 are expected to be comparable to 2011.

RESULTS OF OPERATIONS

The following table reconciles net income (loss) attributable to unitholders for the years ended December 31, 2011 to 2010 and 2010 to 2009. 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)*	**2011 vs. 2010 Total**	2010 vs. 2009 Total
Net income (loss) attributable to unitholders:		
2011 period	$8,754	
2010 period	2,038	$2,038
2009 period	–	(272)
Variance	$6,716	$2,310
Detail of earnings variance:		
Fee Timber		
Log price realizations (A)	$7,306	$4,028
Log volumes (B)	18,076	8,421
Depletion	(6,589)	(3,168)
Production costs	(9,254)	(2,905)
Other Fee Timber	(2,343)	(397)
Timberland Management & Consulting		
Third-party management fees	–	(531)
Other Timberland Management & Consulting	(265)	(344)
Real Estate		
Land and conservation easement sales	554	(1,199)
Environmental remediation liability	(102)	(845)
Timber depletion on HBU sale	(150)	6
Other Real Estate	158	(434)
General & administrative costs	543	(998)
Net interest expense	(540)	(137)
Debt extinguishment costs	1,250	(113)
Noncontrolling interest	(1,391)	268
Other (taxes, investment related)	(537)	658
Total change in earnings	$6,716	$2,310

(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 ground leases for cellular communication towers, gravel mines and quarries, together with the sale of other resources from our timberlands. Our Fee Timber revenue is driven primarily by the volume of timber harvested and the average log price realized on the sale of that harvested timber. 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, 2011, are as follows:

Year End *(in millions)*	Log Sale Revenue	Mineral, Cell Tower & Other Revenue	Total Fee Timber Revenue	Operating Income (Loss)	Harvest Volume (MMBF)
Pope Resources Timber	**$29.5**	**$1.5**	**$31.0**	**$13.6**	**50.7**
Timber Funds	**21.6**	**0.1**	**21.7**	**3.3**	**39.5**
Total Fee Timber 2011	**$51.1**	**$1.6**	**$52.7**	**$16.9**	**90.2**
Pope Resources Timber	$20.7	$1.6	$22.3	$9.5	42.3
Timber Funds	5.1	0.3	5.4	0.2	10.7
Total Fee Timber 2010	$25.8	$1.9	$27.7	$9.7	53.0
Pope Resources Timber	$13.3	$1.5	$14.8	$4.0	32.5
Timber Funds	–	–	–	(0.3)	–
Total Fee Timber 2009	$13.3	$1.5	$14.8	$3.7	32.5

FISCAL YEAR 2011 COMPARED TO 2010. Fee Timber revenue and operating income increased $25.0 million and $7.2 million, respectively, in 2011 from 2010. The increases were the result of a 70% increase in harvest volume from 2010 to 2011 in addition to an $81/MBF, or 17%, increase in average realized log price. The harvest volume increase reflects our response to the improvement in the export market that began in 2010 and continued through 2011. We harvested 27 MMBF more than the 2011 planned harvest of 63 MMBF in response to stronger export markets. This additional volume was only a portion of the deferred volumes that accumulated during the years 2008–2010 on the Combined tree farms when we held back on harvesting due to very weak markets. The export market to China was the driving force for increases in log prices as the China market purchased logs typically directed to domestic sawmills. The operating income increase was relatively smaller than the revenue increase as a result of a higher proportion of harvest from the Funds and the corresponding higher depletion expenses that come with newly acquired properties. In addition, we experienced increased road maintenance costs, which grew from $812,000, or 21%, of Combined tree farm operating expenses in 2010 to $2.4 million, or 41%, of Combined tree farm operating expenses in 2011 as roads were being prepared for higher levels of future harvest operations.

Revenue and operating income for the Funds increased $16.5 million and $3.1 million, respectively, from 2010 to 2011. A nearly fourfold increase in harvest volume coupled with a $78/MBF, or 16%, increase in log price were the factors responsible for the increases. The increase in income for the Funds was less dramatic than the increase in revenue would suggest because of the high depletion rates on Fund properties in addition to a $1.1 million increase in road maintenance costs from 2010 to 2011.

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/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 from both ownerships.

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 compared to no harvest in 2009. The Funds collectively generated revenue of $5.4 million in 2010 compared with $28,000 of revenue in 2009. 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, 2011 was as follows:

Volume *(in MMBF)*	**2011**	**% Total**	2010	% Total	2009	% Total
Sawlogs						
Douglas-fir	55.2	61%	35.0	66%	22.4	69%
Whitewood	18.0	20%	7.1	13%	1.1	3%
Cedar	1.4	1%	0.9	2%	0.8	2%
Hardwoods	2.4	3%	0.9	2%	0.8	3%
Pulpwood						
All Species	13.2	15%	9.1	17%	7.3	23
Total	90.2	100%	53.0	100%	32.5	100%

FISCAL YEAR 2011 COMPARED TO 2010. Harvest volume increased by 37 MMBF, or 70%, from 2010 to 2011 with 29 MMBF, or 77%, of that increase attributable to a boost in Fund harvest. A large percentage of the Funds' previously deferred volume was harvested in 2011 to take advantage of favorable pricing. This elevated the Funds' share of Combined volume mix from 20% in 2010 to 44% in 2011. As described above, the twin decisions to accelerate harvest from both the Partnership's and Funds' tree farms came in response to demand from China that took hold during 2010 and continued through 2011. The shift in year-to-date Combined species mix that saw whitewood volume increase from 13% in 2010 to 20% in 2011, primarily at the expense of Douglas-fir volumes which declined to 61% in 2011 from 66% in 2010, can be attributed to the incremental China export demand, which is largely indifferent to species mix. Since the incremental increase in whitewood log prices greatly exceeded the lift in Douglas-fir prices, and we expected that this surge in whitewood prices would be short-lived, we emphasized the harvesting of timber stands with whitewood as the predominant species. This emphasis played well into boosting harvest volumes from the Funds' tree farms where the inventory has a heavier whitewood component. Our cedar and hardwood volumes are minor components of the overall mix and they stayed relatively consistent year over year, while pulpwood saw a slight decline from 2010 to 2011, even as pulpwood prices rose 23% from 2010 to 2011.

FISCAL YEAR 2010 COMPARED TO 2009. Harvest volume increased by 21 MMBF, or 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 future market conditions.

Log Prices

Logs from the Combined tree farms serve a number of different domestic and export markets, with domestic mills historically representing our largest market segment. During the fourth quarter of 2010 and through 2011, however, logs destined for export markets represented the largest share of our total log sales, as the China market accepted lower quality than what has traditionally defined an export log. As a result, virtually all of what used to be sold to domestic mills instead flowed to the China market during this period. Beginning in the middle of 2010 and through most of 2011, the relative strength of the China export market has been a driving force for much of our log pricing. In contrast to the Japan export market that has historically consisted of the top end of the quality spectrum with a particular preference for Douglas-fir, the China market not only accepts a log quality that is comparable to that which typically goes to the domestic market but is also relatively indifferent as to softwood species.

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 two-year period ended December 31, 2011 was as follows:

	Fiscal Year			
		Δ from 2010 to 2011		
	2011	$/MBF	%	2010
Sawlogs				
Douglas-fir	**$609**	$81	15%	$528
Whitewood	**546**	100	22%	446
Cedar	**923**	6	1%	917
Hardwood	**573**	71	14%	502
Pulpwood				
All Species	**383**	72	23%	311
Overall	**567**	81	17%	486

The 2011 average log price increased $81/MBF, or 17%, over the 2010 average log price. This was principally due to a $102/MBF, or 19%, year-over-year increase in export price in addition to a $100/MBF, or 22%, increase in whitewood prices, and a $72/MBF, or 23%, increase in pulpwood prices. We targeted some stands with a heavier mix of pulpwood during 2011 to take advantage of this uptick in price which was driven by short supplies of residual chips due to a decline in lumber produced from domestic sawmills.

	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

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 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 have historically been very dependent upon the level of new home construction in the U.S. Douglas-fir log prices realized in 2011 reflect some softening of this direct link between Douglas-fir sawlog prices and domestic housing starts offset by a dramatic increase in demand from China for various species of softwood sawlogs and a continuing demand from Japan for the highest grades of Douglas-fir logs. Douglas-fir prices increased $81/MBF, or 15%, when comparing 2011 to 2010, due primarily to strong export markets.

The rally in Douglas-fir sawlogs prices from the lows of 2008 and 2009 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. The aforementioned lumber 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. There was, however, continued strength in the export market to China which created competition for Douglas-fir sawlogs and other softwood species. 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. The two-year $174/MBF, or 40%, increase in Douglas-fir log price more than 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. Though generally considered to be of a lower quality than Douglas-fir, these logs are also used for manufacturing construction grade lumber. Historically, there has been a modest export market for whitewood logs, with most of this volume going to Korea. This changed during 2010 and continued through 2011, as the China market sustained its appetite for softwood logs, with little apparent regard or discrimination as to species. To the extent we were able to access whitewood stands, we harvested this species preferentially to take advantage of its higher relative price lift resulting from surging export demand. This strategy benefitted the Funds' tree farms more than the Partnership tree farms because the former contain a higher proportion of whitewood and the Partnership's whitewood stands tend to be at higher elevations and not easily accessible during winter. In 2011, whitewood prices increased $100/MBF, or 22%, from 2010 due to the export demand for this species. 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. Even more pronounced than the two-year improvement noted above for Douglas-fir, the realized price for whitewoods in 2011 was $237 per MBF, or 77% higher than 2009's average realization of $309 per MBF.

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. Cedar prices remained flat, increasing $6/MBF, or 1%, from 2010 to 2011. A small spike in demand from buyers in 2010 helped drive a $100/MBF, or 12%, increase in cedar prices over 2009.

Hardwood: "Hardwood" can refer to many different species, but on our tree farms, hardwood stands primarily consist 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. Hardwood prices increased $71/MBF, or 14%, in 2011 over the prior year. This was on top of a $56/MBF, or 13%, year-over-year increase from 2009 to 2010 in response to the continued demand for lumber, which came at a time when some mills had relatively low inventories in 2010.

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 in recent 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 logs sold directly to pulp mills as a primary alternative raw material source. During 2011, pulpwood prices increased $72/MBF, or 23%, when compared to 2010. This compares to 2010, when pulpwood prices were up $15/MBF, or 5%, compared to 2009.

Customers

The export market for logs in the Pacific Northwest has been migrating over the last couple of years from a market highly focused on Japan to a market that includes more volume to China and Korea. During the third quarter of 2010, China eclipsed Japan as the largest export log destination from the Pacific Northwest. The Japan market historically required a higher quality log relative to the domestic U.S. market, and is willing to pay a premium for such logs. Under this historical pattern, domestic U.S. sawmills and export customers in Japan had complementary segments of the market. Due to the lower valued end-uses of products manufactured in China and Korea, including concrete forms and pallets, these log markets tend to seek the full complement of domestic and export sorts, as well as a broader range of species such as whitewoods, from the Pacific Northwest. The resultant lower average sawlog quality and more diverse species mix flowing to China and Korea has resulted in a narrowing of the export premium received for sales of logs into these markets. Combined with a higher absolute demand for export logs, this new and broadened source of demand for sawlogs in the Pacific Northwest is expected to continue to exert pricing pressure on domestic mills that have been competing with these offshore sources 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. home building market.

The ultimate decision on where to sell logs is based on the net proceeds we receive after considering the delivered log prices from a prospective customer offset by the hauling cost needed to get logs to that customer. In instances where harvest operations are in close proximity to a mill relative to the export yard of a broker, we will take advantage of favorable haul costs over selling to an export customer whose yard may be a greater distance from a harvest unit. The higher net delivered log value earned by selling to the domestic mill will, in such instances, result in sales of logs originally intended for Asia being diverted to domestic markets. As such, delivered log price movements are influenced by marketing decisions predicated on a net return rather than merely focusing on the delivered log price.

Annual harvest volume and average price paid each year in the three-year period ended December 31, 2011 was as follows:

	2011			2010			2009		
Destination	**Volume**	**%**	**Price**	Volume	%	Price	Volume	%	Price
Export brokers	**40.6**	**45%**	**$628**	17.7	33%	$526	4.9	15%	$581
Domestic mills	**36.4**	**40%**	**565**	26.2	50%	520	20.2	62%	410
Pulpwood	**13.2**	**15%**	**383**	9.1	17%	311	7.3	23%	296
Total	**90.2**	**100%**	**$567**	53.0	100%	$486	32.5	100%	$410

FISCAL YEAR 2011 COMPARED TO 2010. Export brokers purchased 45% of total year-to-date volume compared to 33% during the same period in 2010. In addition, export brokers increased the price they paid by $102/MBF, or 19%, on a year-over-year basis. Nearly all of this increase in volume came at the expense of domestic mills, which purchased 40% of our mix in 2011 compared to 50% in 2010. Notwithstanding the loss in total volume purchased, domestic mills increased prices paid by $45/MBF, or 9%, in an effort to compete with export brokers for logs being sold to the export market. Pulpwood buyers saw a slight decline in logs sold in 2011 compared to the same period in 2010, notwithstanding a $72/MBF, or 23% price increase during the same period. This price increase reflects higher pulp mill demand for whole log chips resulting from sawmill production curtailments.

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 delivered 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.

Another way to look at the impact of these growing export markets is to combine the domestic and export log volumes, which increased $155/MBF, or 35%, in value between 2009 and 2011, from $443/MBF in 2009 to $598/MBF in 2011. This more than offset 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 $443/MBF in 2009. This decline between 2008 and 2009 would have been much steeper had we not had access to these higher levels of export log demand in China and Korea. The combined export and domestic log volumes increased $53/MBF, or 10%, over the four-year period from 2008-2011 from $545/MBF to $598/MBF in 2011.

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 on 12,000 acres of the Funds' properties because these properties are concentrated at low elevations. In contrast, the Columbia tree farm and the 49,000-acre balance of the Funds' properties 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, 2011 was as follows:

Year ended	Q1	Q2	Q3	Q4
2011	**34%**	**21%**	**13%**	**32%**
2010	22%	27%	30%	21%
2009	27%	22%	20%	31%

We entered 2011 with momentum from the burgeoning Chinese export market that began in earnest in the second half of 2010. As the first quarter progressed, we moved quickly to further ramp up harvest activity to meet the demand from our export customers. We were poised for a seasonal second quarter slow-down that did not come to fruition until the third quarter. We experienced another spike in demand during the final quarter of the year, wherein we cut nearly a third of the annual volume in response to that demand.

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 for us 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 following factors enhance our flexibility in responding to fluctuating markets, whether these fluctuations are seasonally driven or not: we do not own any mills or processing facilities that require a minimum volume furnish; low focus on quarterly earnings fluctuations as a result of our thinly traded and followed security; and our practice of permitting excess harvest units so that we have a ready pool of potential harvest units to draw on for expanded market demand.

Cost of Sales

Cost of sales for the Fee Timber segment consists of harvest and haul costs and depletion expense. Harvest, haul, and depletion expenses all vary directly with actual harvest volume. Harvest costs will vary by terrain, with steeper slopes requiring more expensive cable systems with a high labor component, while more moderate slopes can be harvested with mechanized equipment and lower relative labor costs. Harvest and haul costs represent the direct cost incurred to convert trees into logs and deliver those logs to the 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. Readers should note that, because of the relatively recent acquisition dates, and thus relatively higher acquisition costs, of the Funds' tree farms, the depletion rates associated with harvests from those properties is considerably higher than for harvests from the Partnership's tree farms. Depletion expense is calculated by first deriving a depletion rate as follows:

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

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, 2011 was as follows:

Year ended *(in millions)*	Harvest, Haul and Other	Depletion	Total Cost of Sales	Harvest Volume (MMBF)
2011	**$18.2**	**$11.8**	**$30.0**	**90.2**
2010	8.9	5.2	14.1	53.0
2009	6.0	2.0	8.0	32.5

Cost of sales more than doubled from 2010 to 2011 primarily as a result of a 70% increase in Combined harvest volume. The increase in costs was compounded by a shift in harvest volume away from the Partnership tree farms, with a lower historic cost and attendant depletion rate, to include more volume from the Funds' tree farms, with a higher depletion rate reflective of a more recent and higher cost basis. In 2011, volumes were weighted 56% and 44% from Partnership and Funds, respectively. In 2010, harvest volumes were weighted 80% and 20% from the Partnership and Funds tree farms, respectively. Harvest, haul, and other costs were also higher in 2011 over 2010 as we harvested from several units requiring higher cost cable logging and contractors were successful in negotiating higher prices for their services.

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 Partnership's tree farms.

Fee Timber cost of sales, expressed on a per MBF basis for each year in the three-year period ended December 31, 2011, was as follows:

Year ended	Harvest, Haul and Other	Depletion	Total Cost of Sales
2011	**$203**	**$130**	**$333**
2010	167	98	265
2009	184	62	246

Costs of sales increased $68/MBF in 2011 over 2010 with the increase split about evenly between harvest-and-haul costs and depletion expense. The per MBF increase in harvest, haul and other reflects increases in both logging costs due to the addition of units requiring higher cost cable logging as well as in increase in haul costs as a result of longer distances to customers. Cable logging costs were affected by a shortage of contractors in the wake of the industry-wide slowdown of 2008-2010 in which numerous contractors went out of business. In 2011, high export log prices stimulated an industry-wide increase in harvest that exceeded contractor capacity, allowing contractors to demand higher prices for their services. During the same 2008-2010 period many log trucks were converted by their owners to highway freight hauling configuration, creating a shortage of log trucks and thus resulting in slightly higher haul costs when harvest activity rebounded in 2011.

Depletion expense increased $32/MBF, or 33%, in 2011 compared to 2010. This is attributable to a significant increase in the relative harvest from the Funds' tree farms from 2010 to 2011. The Funds' share of the Combined harvest total was 44% in 2011 compared to 20% in 2010.

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.

We use a pooled depletion rate for volume harvested from the Partnership's 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 used and reported only 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.

Depletion expense resulting from timber harvest for each year in the three-year period ended December 31, 2011 was made up of the following:

Year ended December 31, 2011	Partnership		Funds		Combined
Volume harvested (MMBF)	**50.7**	**56%**	**39.5**	**44%**	**90.2**
Rate/MBF	**$63**		**$217**		**$130**
Depletion expense (in thousands)	**$3,171**		**$8,587**		**$11,758**

Year ended December 31, 2010	Partnership		Funds		Combined
Volume harvested (MMBF)	42.3	80%	10.7	20%	53.0
Rate/MBF	$62		$236		$98
Depletion expense (in thousands)	$2,640		$2,529		$5,169

Year ended December 31, 2009	Partnership		Combined
Volume harvested (MMBF)	32.5	100%	32.5
Rate/MBF	$62		$62
Depletion expense (in thousands)	$2,001		$2,001

Partnership 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, most of which was acquired in 2001. As relatively newer acquisitions when compared to the Partnership tree farms, the Funds' tree farms carry a higher depletion rate than our depletion pool for the Partnership tree farms. The increase in 2011 Combined depletion rate over the same period in 2010 reflects the increase of the Funds' share of harvest from 20% in 2010 to 44% in 2011. In 2009, none of the harvest was sourced off of the Funds' properties. The decrease in the Funds' depletion rate is attributable to the shift of merchantable timber into volumes available for harvest from non-merchantable inventory from 2010 to 2011.

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 is typically de minimis and, as was the case in 2011, is excluded from the Fee Timber depletion analysis.

Operating Expenses

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. Operating expenses for the Fee Timber segment increased 53% in 2011 to $5.8 million from $3.8 million in 2010. The increase in year-to-date expenses over the prior year is attributable to increased road building and maintenance costs to facilitate an increase in harvest levels and to prepare roads for future harvest on newly acquired Timber Fund lands. Combined road maintenance costs for 2011 were $2.4 million, compared to $812,000 in 2010, or 41% and 21%, respectively, of Combined operating expenses for the two years. Operating expenses increased $644,000, or 21%, from 2009 to 2010. 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 from 2009 to 2010 due to the addition of 25,000 acres acquired by Fund II in the third quarter of 2010.

Timberland Management & Consulting

Revenue and Operating Income

The Timberland Management & Consulting (TM&C) segment primarily develops timberland investment portfolios on behalf of the Funds. As of December 31, 2011, the TM&C segment managed two private equity timber funds representing $150 million of acquired commercial timberlands. Equity capital in these funds includes a co-investment by the Partnership of 20% of total fund equity capital with the remaining 80% coming from third-party investors. As of December 31, 2011, we have committed capital of $51 million for our third private equity timber fund, ORM Timber Fund III, which included our co-investment of $7 million. We are planning on completing fund raising for this fund by June 2012 with targeted total capital commitments of $100 million. The Partnership will provide a co-investment of between 5% and 10% of total committed capital in the third fund with the balance coming from third-party investors.

See *Accounting Matters – Critical Accounting Policies and Estimates – Timber Fund Management Fees* for more information on accounting for management fees paid by third-party investors.

Revenue and expense generated through the management of the Funds is accounted for within the TM&C segment, accounting guidance requires us to consolidate the Funds' financial performance into our financial statements because of the governance control the Partnership is deemed to have over the Funds. As such, all fees associated with managing the Funds are eliminated in our consolidated financial statements. The revenue generated from management of these Funds represents an expense to the Fee Timber segment which is also eliminated when the Funds are consolidated into the Partnership's financial statements with the portion of those fees paid by third-party investors reflected as income (loss) in the Partnership's consolidated income statement under the caption "Net (income) loss attributable to noncontrolling interests – ORM Timber Funds." Funds I and II are owned 20% by the Partnership and, as a result, 80% of these management fees are paid by third-party investors. Fees will only be earned for management of Fund III after capital has been placed in timberland investments. We generated a total of $2.4 million, $1.5 million, and $908,000 of management fee revenue in 2011, 2010, and 2009, 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 2011 and 2010, the TM&C segment was managing 61,000 acres for the Funds compared with 36,000 acres at the end of 2009. Revenue and operating income for the TM&C segment for each year in the three-year period ended December 31, 2011, were as follows:

Year Ended December 31 *(in millions)*	**2011**	2010	2009
Revenue internal	**$2.4**	$1.5	$1.5
Intersegment eliminations	**(2.4)**	(1.5)	(0.9)
Revenue external	**$0.0**	$0.0	$0.6
Operating income-internal	**$0.4**	$0.0	$0.4
Intersegment eliminations	**(1.9)**	(1.3)	(0.8)
Operating loss-external	**($1.5)**	($1.3)	($0.4)

FISCAL YEAR 2011 COMPARED TO 2010. TM&C had no revenue to report in either 2011 or 2010 after elimination of $2.4 million and $1.5 million, respectively. The addition of approximately 25,000 acres under management for Fund II in the fall of 2010 drove the increase in revenue eliminated in 2011 over 2010.

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. In 2009, we had revenue from a third-party management contract and, as such, resulted in externally reported revenue. The termination of this management contract in July 2009 was the primary reason for the decrease in revenue and increase in operating loss. Further contributing to the increase in operating loss in this segment was 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.

Operating Expenses

FISCAL YEAR 2011 COMPARED TO 2010. TM&C operating expenses increased $234,000 in 2011 over the same period in 2010. The increase in operating expense results from increased costs in connection with higher harvest levels in the Funds, higher personnel related expenses with fund oversight, and administrative costs incurred prior to raising capital for the third fund.

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 the acquisition of two tree farms representing 25,000 acres by Fund II in 2010 compared with the addition of two tree farms totaling 12,000 acres in 2009.

Real Estate

Revenue and Operating Income

The Partnership's Real Estate segment consists primarily of revenue from the sale of land within its 2,800-acre portfolio, sales of conservation easements and timberland tracts from the Partnership's timberland portfolio, and residential and commercial rents from our Port Gamble and Poulsbo properties. The Partnership's Real Estate holdings are located primarily in the Washington counties of Pierce, Kitsap, and Jefferson. 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. Sales of development rights can take different forms, but in 2011 reflected an outright sale of fee simple interest in a 386-acre conservation tract to The Nature Conservancy as well as a CE sale on 255 acres to the State of Washington, with assistance from Forterra. In the case of the 386-acre sale to The Nature Conservancy, the Partnership retained no interest in or harvesting rights to the property post-sale. On the other hand, the 255-acre CE sale allows us to retain harvesting rights and other timberland management rights, but bars any future subdivision of or real estate development on the property. In both 2010 and 2009, we closed on CE sales that similarly prohibit future development or subdivision activities but permit continuing management of the tracts as timberland, including harvesting of timber. The 2010 CE sale encumbered 6,886 acres of the Columbia tree farm and the 2009 CE sale encumbered 2,290 acres of the Hood Canal tree farm.

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, 2011 were as follows:

Year ended	Revenue	Environmental remediation expense	Operating income (loss)
2011	**$4.5**	**$1.0**	**$(0.3)**
2010	3.5	0.9	(0.8)
2009	5.0	–	1.7

Real Estate segment revenue for each year in the three-year period ended December 31, 2011 consisted of the following components:

Description *(in thousands except acres)*	Revenue	Gross Margin	Acres	Per Acre Amounts Revenue	Per Acre Amounts Gross Margin
Conservation easement	**$480**	**$414**	**255**	**$1,882**	**$1,624**
Conservation sale	**1,955**	**1,713**	**386**	**5,065**	**4,438**
Unimproved land	**417**	**347**	**102**	**4,088**	**3,402**
Residential	**484**	**342**	**5**	**96,800**	**68,400**
Total land	**$3,336**	**$2,816**	**748**	**4,460**	**3,765**
Rentals	**1,195**	**1,193**			
Other	**14**	**14**			
2011 Total	**$4,545**	**$4,023**			
Conservation easement	$2,400	$2,244	6,886	$349	$326
Total land	$2,400	$2,244	6,886	349	326
Rentals	1,013	1,011			
Other	74	70			
2010 Total	$3,487	$3,325			
Conservation easement	$3,298	$3,108	2,290	$1,440	$1,357
Residential	521	328	50	10,420	6,566
Total land	$3,819	$3,436	2,340	555	499
Rentals	1,154	1,153			
Other	57	49			
2009 Total	$5,030	$4,638			

FISCAL YEAR 2011 COMPARED TO 2010. Real estate transactions in 2011 included a CE sale to the State of Washington funded by Forterra, a fee simple sale of conservation land to The Nature Conservancy, four unimproved land sales, the sale of a building on two acres we owned in north Seattle, and one residential lot in Kitsap County. We benefitted from an increase in real estate activity in 2011 over 2010, when we only closed a single land transaction — a CE sale. Even though we saw an increase in the number of transactions and total revenue from 2010 to 2011, we experienced a slight decline in gross margin as a percent of sales revenue on land sales from 95% in 2010 to 84% in 2011. This gross margin as a percent of sales erosion is primarily attributable to increased professional costs incurred in connection with some of the 2011 transactions. Operating loss declined $460,000 from $809,000 in 2010 to $349,000 in 2011 due to a $1.1 million increase in revenue offset by $360,000 increase in costs of sales, a $136,000 increase in operating expenses due to an increase in maintenance expenses related to our residential and commercial properties which had been deferred in prior years, and a $102,000 increase in environmental remediation charge over the same period in 2010.

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. In 2009, we closed a $3.3 million CE sale on nearly 2,300 acres. Both of the 2009 and 2010 CE sales were funded by the federal Forest Legacy program and in both cases future development on the property is restricted while continued timberland management and harvest of timber is allowed. The 2010 and 2009 CE sales generated a gross margin of $2.2 and $3.1 million, respectively.

The Real Estate segment generated an operating loss of $809,000 in 2010 compared to operating income of $1.7 million in 2009. This decline in income 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.

Cost of Sales

Real Estate cost of sales for each of the three years ended December 31, 2011, 2010, and 2009 was $522,000, $162,000, and $392,000, respectively, with these amounts comprised of land basis, legal, and other closing costs. CE sales, unlike fee simple sales which include land basis in costs of sales, typically have little or no cost basis written off as part of the transaction.

Operating Expenses

Real Estate operating expenses for each of the three years ended December 31, 2011, 2010, and 2009, were $3.4 million, $3.3 million, and $2.9 million, respectively. Operating expenses in 2011, excluding $977,000 in environmental remediation charges, increased $136,000 over 2010 due to an increase in maintenance related costs on our commercial and residential properties that had been deferred in prior years. Operating expenses, excluding $875,000 in environmental remediation charges, 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.

Basis in Real Estate Projects

"Land Held for Development" on our 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. We capitalize costs that are clearly associated with development or construction of fully entitled projects, whereas costs associated with projects that are in the entitlement phase are expensed. Those properties that are for sale, under contract, and those for which the Partnership has an expectation they will sell within the next 12 months, are classified on our balance sheet as a current asset under "Building and Land Held for Sale." The $1.3 million amount currently in Building and Land Held for Sale reflects our expectation of sales in 2012 of the Partnership's headquarters building in Poulsbo and a 10-acre multi-family parcel from the Harbor Hill project in Gig Harbor.

When facts and circumstances indicate that the carrying value of properties may be impaired, an evaluation of recoverability is performed by comparing the currently recorded 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 the difference between the carrying value and fair market value, and would recognize an expense in 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 any of our development projects.

Environmental Remediation

The Partnership has an accrual for estimated environmental remediation costs of $2.2 million and $1.9 million as of December 31, 2011 and 2010, 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 2011, Department of Ecology (DOE) completed additional sampling requested by a group of stakeholders earlier in the year. The sampling introduced a significant delay in the process toward the goal of modifying the Remedial Investigation (RI) and Feasibility Study (FS) for the townsite/millsite of Port Gamble and issuing a Clean-Up Action Plan (CAP) coincident with a consent decree by the end of 2011. Two factors took on more significance during the fourth quarter clean-up approach and, as such, at December 31, 2011, were incorporated into a Monte Carlo simulation model that we use to estimate such liabilities. These updates to the Monte Carlo simulation model resulted in a $631,000 charge for contingent environmental remediation costs during the fourth quarter. Looking forward into 2012, DOE has suggested that the RI/FS may be finalized in the first half of 2012. This would be followed by a CAP and consent decree and include timetables and financial arrangements for completing the remediation.

The environmental remediation accrual contains costs estimated in connection with a separate remediation effort within the resort community of Port Ludlow. We continue to monitor the site and will remediate contaminated sites if and where required.

The environmental liability at December 31, 2011 is comprised of $240,000 that the Partnership expects to expend in the next 12 months and $2.0 million thereafter. Statistical models have been used to estimate the liability and suggest a potential aggregate range of loss of zero to $4.8 million which represents a two-standard-deviation range from the mean of possible outcomes generated by the modeling process used to estimate the liability. Activity in the environmental remediation liability is detailed as follows:

Year ended December 31 *(in thousands)*	Balances at the Beginning of the Year	Additions to Accrual	Expenditures for Remediation	Balance at Year-end
2011	**$1,933**	**$977**	**$707**	**$2,203**
2010	1,269	875	211	1,933
2009	1,554	30	315	1,269

General & Administrative (G&A)

FISCAL YEAR 2011 COMPARED TO 2010. G&A costs were $4.1 million in 2011 compared to $4.7 million in 2010. The decline is primarily attributable to development and adoption of a new incentive compensation plan first recorded in 2010 that required a catch-up accrual for multi-year performance cycles and the professional fees incurred in connection with the new plan. Professional and legal service fees were also down between 2010 and 2011 by $450,000. Partially offsetting these cost declines, we experienced a slight increase in taxes on management fees and in necessary repairs made to the corporate building in early 2011.

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.

Interest Income and Expense

Interest income for 2011 decreased to $42,000 from $102,000 in 2010 and $219,000 in 2009. 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. The decline in interest income is due primarily to the low cash balances we have been carrying in 2011 since taking a draw on the operating line of credit in December of 2010 to repurchase units.

Interest expense, net of interest capitalized to development projects, was $1.7 million in 2011 and $1.2 million for each of 2010 and 2009. Interest expense increased in 2011 over 2010 due to a full year of interest on the Fund II mortgage coupled with an increase in interest expense related to higher amounts borrowed on the operating line of credit in 2011 over 2010. Interest expense, net of interest capitalized, was static in 2009 and 2010 in spite of the addition of an $11 million mortgage by Fund II. This is due primarily to a decline in borrowing rates. 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 2011 COMPARED TO 2010. We recorded tax expense of $236,000 in 2011 compared to a tax benefit of $290,000 in 2010. The tax expense results from income in the taxable corporate subsidiaries in 2011 as a result of an increase in income from harvest volumes and management fees earned.

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.

Noncontrolling interests – ORM Timber Funds

Noncontrolling interests – ORM Timber Funds represented the 80% portion of 2011 and 2010 net income and losses, respectively, of Funds I and II (and 90%, at a minimum for Fund III), each of which is attributable to third-party owners of the Funds. The increase in income in 2011 compared to 2010 is due to income generated from significantly higher harvests in the Funds. The increase in net loss in 2010 compared to 2009 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.

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 for at least the next twelve months. The Partnership's debt agreements have covenants which are measured quarterly. Among the covenants measured, is a requirement that the Partnership not exceed a maximum debt-to-total-capitalization ratio of 30%, with total capitalization calculated using fair market (vs. carrying) value of timberland, roads and timber. The Partnership is in compliance with this covenant as of December 31, 2011 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 an $18.6 million timberland mortgage held by John Hancock Life Insurance Company (JHLIC) with a stated interest rate of 7.63% due in April 2011. 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 Northwest Farm Credit Services (NWFCS). This new term loan agreement was structured with three tranches with terms of 5, 7, and 15 years that collectively have a weighted average interest rate of 5.3%. A fourth tranche of debt with NWFCS had been taken out previously in 2009 in the amount of $9.8 million with an interest rate of 6.4%. The weighted average interest rate for these four tranches of term debt is 5.6%.

In connection with the 2010 refinancing of term debt, 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. This 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. The debt arrangement between the Partnership and NWFCS includes an annual reimbursement of interest expense (patronage) that has ranged from 35 to 100 basis points between 2000 and 2011. The Partnership's 2011 interest expense was reduced by $239,000, which reflects estimated patronage to be refunded in 2012.

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 loan agreement allows for, but does not require, annual principal payments of up to 10% without incurring a make-whole premium.

Cash and cash equivalents increased $230,000 from 2010 to 2011 due to the increase in cash provided by increased harvest volume and real estate sales, coupled with the absence of a large Fund timberland acquisition that occurred in 2010. 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 repurchase of units. The $5.0 million and $6.0 million variance in cash flow from 2011 to 2010 and 2010 to 2009, respectively, is broken down in the following table:

(in thousands)	**2011**	Change	2010	Change	2009
Cash provided by operations	**$21,660**	$12,710	$8,950	$8,288	$662
Investing activities					
Redemption of investments	**–**	(1,497)	1,497	(318)	1,815
Proceeds from sale of fixed assets	**–**	–	–	(50)	50
Capital expenditures	**(1,911)**	(970)	(941)	283	(1,224)
Acquisition of commercial office building in Poulsbo	**(3,210)**	(3,210)	–	–	–
Timberland acquisition	**(159)**	58,047	(58,206)	(23,785)	(34,421)
Cash provided by (used in) investing activities	**(5,280)**	52,370	(57,650)	(23,870)	(33,780)
Financing activities					
Borrowing on (repayment of) line of credit	**(4,643)**	(14,243)	9,600	9,600	–
Borrowing on (repayment of) long term debt	**(30)**	1,008	(1,038)	380	(1,418)
Extinguishment of long-term debt	**–**	18,554	(18,554)	(10,076)	(8,478)
Proceeds from issuance of long-term debt	**–**	(31,000)	31,000	21,200	9,800
Debt issuance costs	**–**	283	(283)	(212)	(71)
Cash distributions to unitholders	**(5,263)**	(2,022)	(3,241)	(22)	(3,219)
Unit repurchases	**–**	12,267	(12,267)	(10,429)	(1,838)
Cash from option exercises, net	**516**	(106)	622	622	–
Excess tax benefit from equity-based compensation	**96**	96	–	(17)	17
Payroll taxes paid upon restricted unit vesting	**(234)**	(234)	–	–	–
Distributions to fund investors, net of cash to Partnership	**(7,012)**	(6,206)	(806)	(806)	–
Capital call – ORM Timber Fund II, Inc.	**–**	(38,800)	38,800	11,273	27,527
Capital call – ORM Timber Fund III, Inc.	**437**	437	–	–	–
Preferred stock issuance (distribution), net – ORM Timber Fund II, Inc.	**(16)**	(126)	110	110	–
Other	**(1)**	(1)	–	–	–
Cash provided by (used in) financing activities	**(16,150)**	(60,093)	43,943	21,623	22,320
Net increase (decrease) in cash and cash equivalents	**$230**	$4,987	($4,757)	$6,041	($10,798)

OPERATING CASH ACTIVITIES. Cash provided by operating activities increased to $21.7 million in 2011 from $9.0 million in 2010 due primarily to a 70% increase in harvest volumes and a 17% log price increase from the Combined tree farms in addition to a small uptick in real estate activity. Capitalized development costs declined slightly to $893,000 in 2011 compared with $1.1 million in 2010.

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 a 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 a decline in the Partnership's effective borrowing rates.

INVESTING CASH ACTIVITIES. Cash used in investing activities declined by $52.4 million from 2010 to 2011 primarily due to the absence in 2011 of a counterpart to the $58 million timberland acquisition that was made in 2010. This was partially offset by a $4.2 million increase in capital expenditures which reflects the $3.2 million acquisition of a commercial office building in Poulsbo in 2011 in addition to an increase in road, timber, and reforestation expenditures in anticipation of planned harvest activity.

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 increase in acquisition costs related to Fund II properties. In 2009, Fund II acquisitions were approximately $34 million compared to $58 million in 2010. 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.

FINANCING ACTIVITIES. Cash used in financing activities increased $60.1 million in 2011 from 2010 due to primarily to the non-recurrence of a Fund capital call and net proceeds from the refinance of a mortgage that occurred in 2010. This was offset by an increase in payments on long-term debt in 2011 to pay down the operating line of credit in an effort to keep interest costs low as well as an increase in Fund distributions and Partnership distribution costs reflecting a $0.10 per unit increase in the quarterly distribution beginning the third quarter of 2011.

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 calls in each year. The increase is offset by an increase in unit repurchases in 2010 from 2009.

Expected Future Changes to Cash Flows

OPERATING ACTIVITIES. As discussed above, we plan to harvest approximately 75 MMBF to 85 MMBF in 2012. This plan reflects an expectation that the markets in Asia, primarily China and to a lesser extent Japan and Korea, will continue to have an appetite for our products until the domestic market improves. Our budgeted capital expenditures for our Gig Harbor project is expected to total $2.7 million in 2012. The majority of Gig Harbor capital expenditure in 2012 is projected to be for site work, engineering, surveying and overall project management costs following the closing of a multi-family residential parcel.

INVESTING ACTIVITIES. Management has budgeted $2.0 million of capital expenditures for 2012, excluding any potential timberland acquisitions. These investments are primarily comprised of long-term investments supporting our Fee Timber operations.

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, 2011 was 33% and 16% 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 on 12,000 acres of the Funds' properties because these properties are concentrated at low elevations. In contrast, the Columbia tree farm and the 49,000-acre balance of the Funds' properties 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 annual asset management and timberland management fees as well as log marketing fees during periods of active harvesting from the Funds' tree farms. 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, 2011 consist of operating leases, and purchase obligations entered into in the normal course of business.

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 $197,000 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.

	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	$45,825	$32	$4,993	$5,000	$35,800
Operating leases	141	69	69	3	–
Interest on debt	19,434	2,431	4,299	3,673	9,031
Environmental remediation	2,203	240	1,963	–	–
Other long-term obligations	197	25	50	50	72
Total contractual obligations or commitments	$67,800	$2,797	$11,374	$8,726	$44,903

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 2012 are $4.9 million, of which $2.7 million relates to the Gig Harbor site. These expenditures could be increased or decreased as a consequence of future economic conditions. Projected capital expenditures are subject to permitting timetables and progress towards closing on specific land sale transactions.

Government Regulation

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

Additionally, many federal and state environmental regulations, as well as local zoning and land use ordinances, place limits upon various aspects of our operations. These limits include restrictions on our harvest methods and volumes, remediation requirements that may increase our post-harvest reforestation 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 2011, 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. Depletion rate calculations on Funds timberlands, which are recently acquired, are made on a tree farm specific basis. The depletion cost on 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 include only timber whose eventual harvest is not constrained by 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 public resources including clean water and various fish and other wildlife species. Timber inventory volume is accounted for by periodic statistical sampling of the harvestable timbered acres. Since timber stands can be very heterogeneous, the accuracy of the statistical sampling, known as a "timber cruise", of a timber stand can vary. The inventory system is designed in such a way that the accuracy of the whole is very reliable while any subset, or individual timber stand, will have a wider range of accuracy. The Partnership's standing timber inventory system 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 update process and the second is a comparison of the volume actually extracted by harvest to the inventory in the standing inventory system at the time of the harvest. 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. The inventory to harvested volume comparison utilizes subsets of the total inventory which have been sampled sometime in the last ten years and grown annually using yield tables built on more statistical data; due to the nature of statistical sampling the results of the annual timber inventory to harvested volume comparison is meaningful only in the context of accumulated results over several years, and not in the context of a single harvest unit.

A hypothetical 5% change in estimated timber inventory volume would have changed 2011 depletion expense by $244,000.

ENVIRONMENTAL REMEDIATION. The Partnership has an accrual for estimated environmental remediation costs of $2.2 million and $1.9 million as of December 31, 2011 and 2010, 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 2011, Department of Ecology (DOE) completed additional sampling requested by a group of stakeholders earlier in the year. The sampling introduced a significant delay in the process toward the goal of modifying the Baywide and Millsite Remedial Investigation (RI) and Feasibility Study (FS) and issuing a Clean-Up Action Plan (CAP) coincident with a consent decree by the end of 2011. Two factors took on more significance during the fourth quarter clean-up approach and, as such, at December 31, 2011 were incorporated into a Monte Carlo simulation model that we use to estimate such liabilities. These updates to the Monte Carlo simulation model resulted in a $631,000 charge for contingent environmental remediation costs during the fourth quarter. Looking forward into 2012, DOE has suggested that the RI/FS may be finalized in the first half of 2012. This would be followed by a CAP and consent decree and include timetables and financial arrangements for completing the remediation.

The environmental remediation accrual contains costs estimated in connection with a separate remediation effort within the resort community of Port Ludlow. We continue to monitor this site and will remediate contaminated sites if and where required.

The environmental liability at December 31, 2011 is comprised of $240,000 that the Partnership expects to expend in the next 12 months and $2.0 million thereafter. Statistical models have been used to estimate the liability and suggest a potential aggregate range of loss of zero to $4.8 million which represents a two-standard-deviation range from the mean of possible outcomes generated by the modeling process used to estimate the liability.

PROPERTY DEVELOPMENT COSTS. The Partnership is developing three master planned communities in Gig Harbor, Kingston, and Port Gamble. 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 based on management's expectation of when the sales will occur ("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.

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 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, for the difference between the carrying value and the 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), ORM TIMBER FUND II, INC. (FUND II), AND ORM TIMBER FUND III (REIT) INC. (FUND III). Fund I and Fund II are owned 19% by Pope Resources, A Delaware Limited Partnership, 1% by Olympic Resource Management LLC ("ORMLLC") (a wholly owned subsidiary of the Partnership), and the Partnership will own between 5% and 10% of Fund III with the remaining owned by third-party investors. ORMLLC is the general partner of Fund I and the manager of Funds II and III. 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 the Funds. Based upon this governance structure, ORMLLC has presumptive control of the Funds and, as a result, under accounting rules the Funds must be consolidated into the Partnership's financial statements.

TIMBER FUND MANAGEMENT FEES. The Partnership's wholly owned subsidiary, ORMLLC, earns management fees related to managing the funds. As a result, the Partnership's consolidated financial statements, excluding the Funds, include 100% of these management fees as revenue. The stand-alone financial statements for the Funds include 100% of these management fees as expenses. The dollar amounts are the same, allowing for elimination of these two amounts in consolidation, and initially, no income impact in consolidation. However, each fund is 80% owned by third-party investors, and, as a result, 80% of these management fees are paid by these third-party investors. The 80% of management fees paid by third-party investors flows to the Partnership's Statement of Operations under the caption "Net (income) loss attributable to noncontrolling interest-ORM Timber Funds," effectively bringing the 80% of management fees back into consolidated income of the Partnership.

Total management fees of $2.4 million and $1.5 million were generated in 2011 and 2010, respectively. To summarize the aforementioned consolidation process, these management fees were eliminated from revenue in the Partnership's TM&C segment and from operating expenses in the Partnership's Fee Timber segment. The 80% of management fees paid by third-party investors in the funds were added back to consolidated income in the Statement of Operations under the caption "Net loss attributable to noncontrolling interests: ORM Timber Funds."

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 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. Approximately $473,000 of equity compensation expense related to this program was recognized in 2011. As of December 31, 2011, we had accrued $1.9 million, with $220,000 of that total attributable to the cash component of the PRU element and the balance of $1.7 million attributable to the LTIP portion.

Consolidated Balance Sheets

Years ended December 31 (in thousands)	**2011**	2010
ASSETS		
Current assets		
Partnership cash and cash equivalents	$249	$237
ORM Timber Funds cash and cash equivalents	2,404	2,186
Cash and cash equivalents	2,653	2,423
Accounts receivable, net	1,876	543
Building and land held for sale	1,255	3
Current portion of contracts receivable	80	219
Prepaid expenses and other	853	805
Total current assets	6,717	3,993
Properties and equipment, at cost		
Timber and roads, net of accumulated depletion of $71,955 and $60,044	154,236	164,961
Timberland	34,130	33,980
Land held for development	28,413	27,737
Buildings and equipment, net of accumulated depreciation of $6,203 and $7,739	6,019	3,854
Total properties and equipment, at cost	222,798	230,532
Other assets		
Contracts receivable, net of current portion	409	652
Other	484	660
Total other assets	893	1,312
Total assets	$230,408	$235,837

LIABILITIES, PARTNERS' CAPITAL AND NONCONTROLLING INTERESTS		
Current liabilities		
Accounts payable	$1,328	$868
Accrued liabilities	3,021	2,656
Current portion of long-term debt	32	30
Deferred revenue	447	674
Other current liabilities	468	588
Total current liabilities	5,296	4,816
Long-term debt, net of current portion	45,793	50,468
Other long-term liabilities	2,161	1,746
Commitments and contingencies		
Partners' capital		
General partners' capital (units issued and outstanding 60 and 60)	1,063	992
Limited partners' capital (units issued and outstanding 4,269 and 4,203)	74,696	69,998
Noncontrolling interests	101,399	107,817
Total partners' capital and noncontrolling interests	177,158	178,807
Total liabilities, partners' capital, and noncontrolling interests	$230,408	$235,837

See accompanying notes to consolidated financial statements.

Consolidated Statements of Operations

Years ended December 31 (in thousands, except per unit information)	**2011**	2010	2009
Revenue			
Fee Timber	**$52,729**	$27,674	$14,847
Timberland Management & Consulting	**–**	31	601
Real Estate	**4,545**	3,487	5,030
Total revenue	**57,274**	31,192	20,478
Costs and expenses			
Cost of sales			
Fee Timber	**(30,042)**	(14,184)	(7,980)
Real Estate	**(522)**	(162)	(392)
Total cost of sales	**(30,564)**	(14,346)	(8,372)
Operating expenses			
Fee Timber	**(5,788)**	(3,787)	(3,143)
Timberland Management & Consulting	**(1,515)**	(1,281)	(976)
Real Estate	**(3,395)**	(3,259)	(2,945)
Environmental remediation	**(977)**	(875)	(30)
General & Administrative	**(4,188)**	(4,731)	(3,733)
Total operating expenses	**(15,863)**	(13,933)	(10,827)
Operating income (loss)			
Fee Timber	**16,899**	9,703	3,724
Timberland Management & Consulting	**(1,515)**	(1,250)	(375)
Real Estate	**(349)**	(809)	1,663
General & Administrative	**(4,188)**	(4,731)	(3,733)
Total operating income	**10,847**	2,913	1,279
Other income (expense)			
Interest expense	**(2,158)**	(1,815)	(2,317)
Interest capitalized to development projects	**432**	569	1,091
Interest income	**42**	102	219
Net gain (loss) on student loan auction rate securities dispositions	**–**	11	(66)
Impairment of student loan auction rate securities	**–**	–	(252)
Total other expense	**(1,684)**	(1,133)	(1,325)
Debt extinguishment costs	**–**	(1,250)	(1,137)
Income (loss) before income taxes	**9,163**	530	(1,183)
Income tax benefit (expense)	**(236)**	290	(39)
Net income (loss)	**8,927**	820	(1,222)
Net (income) loss attributable to noncontrolling interests – ORM Timber Funds	**(173)**	1,218	950
Net income (loss) attributable to unitholders	**$8,754**	$2,038	($272)
Allocable to general partners	**$121**	$27	($4)
Allocable to limited partners	**$8,633**	$2,011	($268)
Earnings (loss) per unit attributable to unitholders:			
Basic	**$1.94**	$0.43	($0.07)
Diluted	**$1.94**	$0.43	($0.07)
Distributions per unit	**$1.20**	$0.70	$0.70

See accompanying notes to consolidated financial statements.

Consolidated Statements of Partners' Capital

Years ended December 31 (in thousands)	Attributable to Pope Resources General Partners	Attributable to Pope Resources Limited Partners	Noncontrolling Interests	Total
December 31, 2008	$1,146	$86,671	$44,354	$132,171
Net 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 (loss)	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
Net income	121	8,633	173	8,927
Cash distributions	(72)	(5,191)	(7,028)	(12,291)
Proceeds from option exercises	7	509	–	516
Capital call	–	–	437	437
Excess tax benefit from equity-based compensation	6	90	–	96
Equity-based compensation	12	888	–	900
Indirect repurchase of units for minimum tax withholding	(3)	(231)	–	(234)
December 31, 2011	$1,063	$74,696	$101,399	$177,158

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Years ended December 31 (in thousands)	**2011**	2010	2009
Cash flows from operating activities			
Cash received from customers	**$56,076**	$31,289	$20,854
Cash paid to suppliers and employees	**(31,609)**	(19,210)	(16,533)
Interest received	**47**	103	280
Interest paid, net of amounts capitalized	**(1,924)**	(903)	(1,226)
Debt extinguishment costs	**–**	(1,250)	(1,137)
Capitalized development activities	**(893)**	(1,075)	(1,639)
Income taxes received (paid)	**(37)**	(4)	63
Net cash provided by operating activities	**21,660**	8,950	662
Cash flows from investing activities			
Capital expenditures	**(5,121)**	(941)	(1,224)
Proceeds from sale of fixed assets	**–**	–	50
Redemption of investments	**–**	1,497	1,815
Timberland acquisitions	**(159)**	(58,206)	(34,421)
Net cash used in investing activities	**(5,280)**	(57,650)	(33,780)
Cash flows from financing activities			
Repayment of (draw on) line of credit, net	**(4,643)**	9,600	–
Repayment of long-term debt	**(30)**	(1,038)	(1,418)
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)
Unit repurchases	**–**	(12,267)	(1,838)
Proceeds from option exercises	**516**	622	–
Payroll taxes paid upon restricted unit vesting	**(235)**	–	–
Excess tax benefit from equity-based compensation	**96**	–	17
Cash distributions to unitholders	**(5,263)**	(3,241)	(3,219)
Cash distributions – ORM Timber Funds, net of distributions to Partnership	**(7,012)**	(806)	–
Capital call – ORM Timber Fund II, Inc.	**–**	38,800	27,527
Capital call – ORM Timber Fund III, Inc.	**437**	–	–
Preferred stock issuance (distribution), net – ORM Timber Fund II, Inc.	**(16)**	110	–
Net cash provided by (used in) financing activities	**(16,150)**	43,943	22,320
Net increase (decrease) in cash and cash equivalents	**230**	(4,757)	(10,798)
Cash and cash equivalents			
Beginning of year	**2,423**	7,180	17,978
End of year	**$2,653**	$2,423	$7,180

See accompanying notes to consolidated financial statements.

Schedule to Consolidated Statements of Cash Flows

Years ended December 31 (in thousands)	**2011**	2010	2009
Reconciliation of net income (loss) to net cash provided by operating activities			
Net income (loss)	**$8,927**	$820	($1,222)
Depletion	**11,908**	5,169	2,001
Capitalized development activities, net of reimbursements	**(893)**	(1,075)	(1,639)
Equity-based compensation	**900**	712	621
Excess tax benefit from equity-based compensation	**(96)**	–	(17)
Depreciation and amortization	**701**	642	810
(Gain) loss on investments	**–**	(11)	318
Deferred taxes, net	**90**	(252)	(222)
Cost of land sold	**112**	67	127
Write-off of debt issuance costs	**–**	32	–
Increase (decrease) in cash from changes in operating accounts			
Accounts receivable	**(1,353)**	(282)	239
Contracts receivable	**382**	174	11
Prepaid expenses and other current assets	**(10)**	(71)	(138)
Accounts payable and accrued liabilities	**921**	2,157	(45)
Deferred revenue	**(227)**	205	126
Other current liabilities	**37**	(6)	35
Environmental remediation	**271**	664	(285)
Other long-term liabilities	**(13)**	5	(31)
Other long-term assets	**(1)**	–	(6)
Other, net	**4**	–	(21)
Net cash provided by operating activities	**$21,660**	$8,950	$662

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 the following: ORM, Inc., which is responsible for managing Pope Resources' timber properties; Olympic Resource Management LLC (ORMLLC), 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 together with 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 ORM Timber Fund I, LP (Fund I), ORM Timber Fund II, Inc. (Fund II), and ORM Timber Fund III, Inc. (Fund III, and collectively with Fund I and Fund II, the Funds). With respect to Funds I and II, ORMLLC is the general partner and owns 1% while Pope Resources owns 19%. ORMLLC is the general partner of Fund III and the Partnership will provide a co-investment of between 5 and 10% of total committed capital in the third Fund. The purpose of all three Funds is to invest in timberlands. See Note 2 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 the Funds. Real Estate consists of obtaining and entitling 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.

Noncontrolling interests

Noncontrolling interests represents the 80%–95% interest in the Funds owned by third-party investors. These entities are consolidated into Pope Resources' financial statements due to our control over the entities (see Note 2).

Noncontrolling interests – ORM Timber Funds represented the portion of 2011 and 2010 net income and losses, respectively, of the Funds, each of which is attributable to third-party owners of the Funds.

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 and collateral on contracts. The Partnership's allowance for doubtful accounts on accounts receivable is $14,670 and $10,423 at December 31, 2011 and 2010, 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, 2011, minimum principal payments on contracts receivable for the next five years and thereafter are due as follows (in thousands):

2012	$80
2013	16
2014	167
2015	13
2016	103
Thereafter	110
Total	$489

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, if any, 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. The Partnership is not aware of any tax exposure items as of December 31, 2011 and 2010. The Partnership has concluded that it is more likely than not that it's deferred tax assets will be realizable and thus no valuation allowance has been recorded as of December 31, 2011. 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.

Building and land held for sale and land held for development

Building and land held for sale and Land held for development are recorded at either cost or the lower of cost or fair value less the cost to sell. Those properties that are for sale, under contract, or the Partnership has an expectation they will sell within 12 months are classified on our balance sheet as a current asset under "Building and Land Held for Sale." The $1.3 million currently in Building and Land Held for Sale reflects our expectation of sales in 2012 of the Partnership's headquarters building in Poulsbo and a 10-acre multi-family parcel from the Harbor Hill project in Gig Harbor.

Land held for development represents the Partnership's cost basis in land that has been identified as having greater value as development property rather than as timberland. Project costs, including interest, clearly associated with development or construction of fully entitled projects are capitalized, whereas costs associated with projects that are in the entitlement phase are expensed. Interest capitalization ceases once projects reach the point of substantial completion or construction activity has been intentionally delayed.

Timberland, timber and roads

Timberland, timber and roads are recorded at cost. 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 rate is calculated by dividing estimated merchantable timber inventory of the pools into the cost basis of merchantable inventory of the pools as of the beginning of the year. The resulting rate is applied to timber harvested during the year to determine timber depletion expense. 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. Each tree farm within the Funds is considered a separate pool and 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. Timberland is not subject to depletion.

Properties 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 currently recorded carrying value of the property to the projected future undiscounted cash flows of the same property. If it is determined that the carrying value of such assets may not be fully recoverable, we would recognize an impairment loss, adjusting for the difference between the carrying value and the estimated fair market value, and would recognize an expense in this amount against current operations.

Buildings and equipment are recorded at cost and consisted of the following as of December 31, 2011 and 2010 (in thousands):

Description	12/31/2011	12/31/2010
Buildings	$8,507	$8,177
Equipment	3,083	2,795
Furniture and fixtures	632	621
Total	$12,222	$11,593
Accumulated depreciation	(6,203)	(7,739)
Net buildings and equipment	$6,019	$3,854

Deferred revenue

Deferred revenue represents the unearned portion of cash collected. The respective balances of $447,000 and $674,000 at December 31, 2011 and 2010, respectively, primarily represent the unearned portion of rental payments received on cell tower leases.

Revenue recognition

Revenue on timber sales is recorded when title and risk of loss passes to the buyer. Revenue on real estate sales is recorded on the date the sale closes, upon receipt of adequate down payment, and receipt of the buyer's obligation to make sufficient continuing payments towards the purchase of the property and the Partnership has no continuing involvement with the real estate sold. The Partnership 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 conservation easement (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.

The Partnership had two conservation related sales in 2011. The first was a 386-acre fee interest sale to The Nature Conservancy for approximately $2.0 million.

The second was the sale of a 255-acre CE to the state of Washington with assistance from Forterra in December 2011. This CE imposes restrictions on the development of the property encumbered by the CE but allows for continued management of the property as industrial timberlands, including harvest of timber. The CE sale provided revenue of $480,000.

In December 2010, the Partnership sold a $2.4 million CE on nearly 6,900 acres in Skamania County, Washington. The sale was funded by the federal Forest Legacy program and, similar to the 2011 CE, restricts future development on the property while allowing continued management and harvest of timber. The revenue for these 2010 and 2011 conservation sales 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 on the date of grant 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, 2011, total compensation expense related to non-vested awards not yet recognized was $633,000 with a weighted average 17 months remaining to vest.

Income (loss) per partnership unit

Basic net earnings (loss) per unit are calculated by dividing net income (loss) attributable to unitholders, adjusted for non-forfeitable distributions paid out to unvested restricted unitholders and Fund II preferred shareholders, by the weighted average units outstanding during the period. Diluted net earnings (loss) per unit are calculated by dividing net income (loss) attributable to unitholders, adjusted for non-forfeitable distributions paid out to unvested restricted unitholders and 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, unless the assumed exercise is antidilutive.

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)	**2011**	2010	2009
Average per unit trading price	**$43.15**	$30.80	$21.07
Total options outstanding	**5,500**	47,874	163,053
Less: options with strike price above average trading price (out-of-the-money)	**–**	(1,464)	(41,323)
Options used in calculation of dilutive unit equivalents	**5,500**	46,410	121,730
Net income (loss) attributable to Pope Resources' unitholders	**$8,754**	$2,038	($272)
Dilutive unit equivalents	**2**	24	42
Less: unit equivalents considered anti-dilutive due to net loss in period	**–**	–	(42)
Dilutive unit equivalents used to calculate dilutive EPS	**2**	24	–

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

	Year Ended December 31,		
(in thousands)	**2011**	2010	2009
Net income (loss) attributable to Pope Resources' unitholders	**$8,754**	$2,038	($272)
Net income attributable to unvested restricted unitholders	**(341)**	(45)	(39)
Dividends paid to Fund II preferred shareholders	**(16)**	(15)	–
Net income (loss) attributable to outstanding unitholders	**$8,397**	$1,978	($311)
Weighted average units outstanding:			
Basic	**4,323**	4,554	4,539
Dilutive effect of unit equivalents	**2**	24	–
Diluted	**4,325**	4,578	4,539
Earnings (loss) per unit: Basic	**$1.94**	$0.43	($0.07)
Earnings (loss) per unit: Diluted	**$1.94**	$0.43	($0.07)

For 2011, there were no options excluded from the calculation of dilutive unit equivalents. This compares to 2010 when 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 and 2009, when options to purchase 41,323 units at prices ranging from $21.35 to $37.73 were anti-dilutive and, as such, excluded from the dilutive unit equivalent calculation.

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.

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 unit.

Fair Value Hierarchy

FAIR VALUE MEASUREMENTS

We use a fair value hierarchy in accounting for certain nonfinancial assets and liabilities including long-lived assets (asset groups) measured at fair value for an impairment assessment.

The fair value hierarchy is based on inputs to valuation techniques that are used to measure fair value that are either observable or unobservable. Observable inputs reflect assumptions market participants would use in pricing an asset or liability based on market data obtained from independent sources while unobservable inputs reflect a reporting entity's pricing based upon its own market assumptions.

The fair value hierarchy consists of the following three levels:

- *Level 1 — Inputs are quoted prices in active markets for identical assets or liabilities.*
- *Level 2 — Inputs are: (a) quoted prices for similar assets or liabilities in an active market, (b) quoted prices for identical or similar assets or liabilities in markets that are not active, or (c) inputs other than quoted prices that are observable and market-corroborated inputs, which are derived principally from or corroborated by observable market data.*
- *Level 3 — Inputs are derived from valuation techniques in which one or more significant inputs or value drivers are unobservable.*

2. ORM TIMBER FUND I, LP (FUND I), ORM TIMBER FUND II, INC. (FUND II), AND ORM TIMBER FUND III (REIT) INC. (FUND III)

The Funds were formed by Olympic Resource Management LLC (ORMLLC), a wholly owned subsidiary of Pope Resources, for the purpose of attracting 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. Each Fund will operate for a term of ten years from the end of the drawdown period, with Fund I terminating in August 2017, Fund II terminating in March 2021, and Fund III with an as-yet-undefined term because its drawdown period is still open. Fund III has a final close expected in June 2012 to be followed by investment of the capital. Fund III's term of ten years will begin after the capital is fully invested.

Pope Resources and ORMLLC together own 20% of Fund I and Fund II and will own between 5% and 10% of Fund III. All Funds are consolidated into the Partnership's financial statements. The Funds' statements of operations for the year ended December 31, 2011 reflects income of $942,000 and losses of $1.3 million and $1.2 million for the years ended December 31, 2010 and 2009, respectively. These operations include management fees paid to ORMLLC of $2.4 million, $1.5 million, and $908,000 for 2011, 2010, and 2009, respectively, which are eliminated in consolidation.

The Partnership's consolidated financial statements include Fund I, Fund II, and Fund III assets and liabilities at December 31, 2011 and 2010, which were as follows:

(in thousands)	**2011**	2010
Cash	**$2,404**	$2,186
Other current assets	**546**	413
Timber, Timberland and roads (net of $13,729 and $5,141 of accumulated depletion in 2011 and 2010)	**136,313**	144,063
Other long-term assets	**126**	141
Total assets	**$139,389**	$146,803
Current liabilities excluding long-term debt	**$1,525**	$954
Current portion of long-term debt	**32**	30
Total current liabilities	**1,557**	984
Long-term debt	**11,036**	11,068
Funds' equity	**126,796**	134,751
Total liabilities and equity	**$139,389**	$146,803

The table above includes management fees payable to the Partnership of $444,000 and $416,000 as of December 31, 2011 and 2010, respectively. These amounts are eliminated in the Partnership's Consolidated Balance Sheets.

3. LONG-TERM DEBT

	Year Ended December 31,	
(in thousands)	**2011**	2010
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**	$5,000
Seven-year tranche, interest at 4.85% with monthly interest-only payments. Matures in July 2017.	**5,000**	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**	10,000
	29,800	29,800
Operating line of credit, variable interest rate based on LIBOR plus 2.25%, with monthly interest-only payments. Matures August 2013.	**4,957**	9,600
Total Partnership debt	**34,757**	39,400
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.	**68**	98
Fund II mortgage payable to MetLife, interest at 4.85%, collateralized by Fund II timberlands with quarterly interest payments maturing September 2020.	**11,000**	11,000
Total ORM Timber Funds debt	**11,068**	11,098
Consolidated subtotal	**45,825**	50,498
Less current portion	**(32)**	(30)
Consolidated long-term debt, less current portion	**$45,793**	$50,468

The Partnership's debt agreements have covenants which are measured quarterly. Among the covenants measured, is a requirement that the Partnership not exceed a maximum debt-to-total-capitalization ratio of 30%, with total capitalization calculated using fair market (vs. carrying) value of timberland, roads and timber. The Partnership is in compliance with this covenant as of December 31, 2011 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.

Fund II's debt agreement contains a requirement to maintain a loan-to-value ratio of less than 40%, with the denominator defined as appraised value. Fund II is in compliance with this covenant as of December 31, 2011 and expects to remain in compliance for at least the next 12 months.

At December 31, 2011, principal payments on long-term debt for the next five years and thereafter are due as follows (in thousands):

2012	$32
2013	4,993
2014	–
2015	5,000
2016	–
Thereafter	35,800
Total	$45,825

On April 16, 2010 we used existing cash balances along with proceeds from our operating line of credit to retire an $18.6 million timberland mortgage held by John Hancock Life Insurance Company (JHLIC) with a stated interest rate of 7.63% due in April 2011. 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 Northwest Farm Credit Services (NWFCS). This new term loan agreement was structured with three tranches with terms of 5, 7, and 15 years that collectively have a weighted average interest rate of 5.3%. A fourth tranche of debt with NWFCS had been take out previously in 2009 in the amount of $9.8 million with an interest rate of 6.4% The weighted average interest rate for these four tranches of term debt is 5.6%.

In connection with the 2010 refinancing of term debt, 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. This line of credit had $5.0 million drawn as of December 31, 2011, down from $9.6 million 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, 2011. The interest rate under this credit facility uses LIBOR as a benchmark. The spread above the benchmark rate is variable depending on the Partnership's trailing twelve-month interest coverage ratio but ranges from 225 to 325 basis points. As of December 31, 2011 the rate (benchmark plus the spread) was 255 basis points. The debt arrangement between the Partnership and NWFCS includes an annual reimbursement of interest expense (patronage). The Partnership's 2011 interest expense was reduced by $239,000, which reflects estimated patronage to be refunded in 2012 with the related receivable recorded within Accounts Receivable as of December 31, 2011.

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 an interest rate of 4.85%. The loan 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 $494,000 and $453,000 at December 31, 2011 and 2010, respectively, and is included in accrued liabilities.

4. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Partnership's financial instruments include cash and cash equivalents 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 $40.9 million as of December 31, 2011 and 2010, respectively, has been estimated based on current interest rates for similar financial instruments, Level 2 inputs in the Fair Value Hierarchy, to be approximately $46.6 million and $41.9 million, respectively.

5. INCOME TAXES

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

(in thousands)	**2011**	2010	2009
Income (loss) before income taxes	**$9,163**	$530	($1,183)
Less: Income/(loss) earned in entities that pass-through pre-tax earnings to the partners	**8,427**	1,408	(1,263)
Income (loss) subject to income taxes	**$736**	($878)	$80

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

(in thousands)	**2011**	2010	2009
Current	**(242)**	$38	($278)
Deferred	**(90)**	252	222
Paid in capital	**96**	–	17
Total	**($236)**	$290	($39)

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

	2011	2010	2009
Statutory tax on income	**34%**	34%	34%
Income earned in entities that pass-through pre-tax earnings to the partners	**(31%)**	(67%)	(37%)
Effective income tax rate	**3%**	(33%)	(3%)

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

(in thousands)	**2011**	2010	2009
Current (included in prepaid expenses and other)	**$439**	$401	$111
Non-current (included in other assets)	**207**	335	373
Total	**$646**	$736	$484

The deferred tax assets are comprised of the following:

(in thousands)	**2011**	2010	2009
Compensation-related accruals	**$628**	$647	$403
Depreciation	**54**	38	25
Other	**(36)**	51	56
Total	**$646**	$736	$484

6. 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 978,544 units authorized but unissued as of December 31, 2011.

One of the two components of the new incentive compensation program adopted in 2010 is the Performance Restricted Unit (PRU) plan which includes both a cash and equity component. Compensation expense relating to the PRUs will vest 25% per year over a 4 year future service period. The first equity grants pursuant to this new program were made in January 2011. The second component of the new incentive compensation program is the Long-Term Incentive Plan (LTIP) which is paid in cash. The LTIP awards contain a market condition whereby the award amount is based upon the Partnership's total shareholder return (TSR) as compared to the TSR of a peer group of 23 companies, measured over a rolling three-year performance period. The market condition component requires the company's projected cash payout to be remeasured quarterly based upon the Partnership's relative TSR ranking, using a Monte Carlo simulation model.

Total equity compensation expense for 2011 was $900,000, of which $473,000 of equity compensation expense was related to the PRU plan. The remaining expense was related to amortization of restricted units issued under the 2005 Plan, but not part of the new incentive compensation program. As of December 31, 2011, we accrued $2.0 million relating to the incentive compensation program, with $220,000 of that total attributable to that portion of the PRU that is to be paid out in cash. This compares with December 31, 2010 when we had accrued $1.5 million for such liabilities, with $200,000 related to the cash-payout component of the PRU.

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. Upon either the exercise of options or vesting of restricted units, grantees have the choice of tendering back units to pay for their option exercise price and minimum tax withholdings.

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, and thus are considered participating securities, 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 on the date of grant are expensed immediately.

Restricted unit activity for the three years ended December 31, 2011 was as follows:

	Units	Weighted Avg Grant Date Fair Value ($)
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
Grants	**26,500**	38.64
Vested, net of units tendered back	**(26,431)**	32.38
Tendered back to pay tax withholding	**(6,242)**	31.91
Outstanding December 31, 2011	**58,500**	31.54

Unit Options

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	Weighted Avg Exercise Price ($)
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
Exercised	**(39,982)**	**13.81**
Tendered back to pay exercise price and tax withholding	**(2,392)**	**12.26**
Outstanding and Vested December 31, 2011	**5,500**	**16.35**

There are no unvested unit options at December 31, 2011.

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, 2011 was $147,000. The weighted average remaining contractual term for all outstanding and exercisable options at December 31, 2010 was 1.9 years.

7. PARTNERSHIP UNIT REPURCHASE PLANS

The Partnership adopted a unit repurchase plan in December 2008 pursuant to which authorization was granted 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 2012. As of December 31, 2011, there remained an unutilized authorization for unit repurchases of $2.5 million.

8. EMPLOYEE BENEFITS

As of December 31, 2011 all employees of the Partnership and its subsidiaries are eligible to receive benefits under a defined contribution plan. During the years 2009 through 2011 the Partnership matched 50% of employees' contributions up to 8% of an individual's compensation. The Partnership's contributions to the plan amounted to $128,000, $123,000, and $131,000 for the years ended December 31, 2011, 2010, and 2009 respectively.

9. COMMITMENTS AND CONTINGENCIES

Environmental remediation

The Partnership has an accrual for estimated environmental remediation costs of $2.2 million and $1.9 million as of December 31, 2011 and 2010, 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 2011, Department of Ecology (DOE) completed additional sampling requested by a group of stakeholders earlier in the year. The sampling introduced a significant delay in the process toward the goal of modifying the Port Gamble Baywide and Millsite Remedial Investigation (RI) and Feasibility Study (FS) and issuing a Clean-Up Action Plan (CAP) coincident with a consent decree by the end of 2011. Two factors took on more significance during the fourth quarter clean-up approach and, as such, at December 31, 2011 were incorporated into a Monte Carlo simulation model that we use to estimate such liabilities. These updates to the Monte Carlo simulation model resulted in a $631,000 fourth quarter of 2011 charge for environmental remediation costs. Looking into 2012, DOE has suggested that the RI/FS may be finalized in the first half of 2012. This would be followed by a CAP and consent decree and include timetables and financial arrangements for completing the remediation.

The environmental remediation accrual contains costs estimated in connection with a separate remediation effort within the resort community of Port Ludlow. We continue to monitor this site and will remediate contaminated sites if and where required. Additionally, the Partnership recorded a $346,000 charge during the year related to a second and separate remediation effort at Port Gamble. A No-Further-Action letter was received in the third quarter of 2011 and, as such, the remediation effort is considered complete and closed.

The environmental liability at December 31, 2011 is comprised of $240,000 that the Partnership expects to expend in the next 12 months and $2.0 million thereafter. Statistical models have been used to estimate the liability and suggest a potential aggregate range of loss of zero to $4.8 million which represents a two-standard-deviation range from the mean of possible outcomes generated by the modeling process used to estimate the liability.

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 $291,000 and $340,000 outstanding at December 31, 2011 and 2010, respectively.

Operating leases

The Partnership has non-cancelable operating leases for automobiles, office space, and computer equipment. The lease terms are from 12 to 60 months. Rent expense under the operating leases totaled $52,000, $79,000, and $105,000 for the years ended December 31, 2011, 2010, and 2009, respectively.

At December 31, 2011 future annual minimum rental payments under non-cancelable operating leases were as follows:

Year	Amount
2012	$69,000
2013	50,000
2014	15,000
2015	4,000
2016	3,000

Supplemental employee retirement plan

The Partnership has a supplemental employee retirement plan for a retired key employee. The plan provides for a retirement income of 70% of his base salary at retirement after taking into account both 401(k) and Social Security benefits with a fixed payment set at $25,013 annually. The Partnership accrued $11,000 and $31,000 in 2011 and 2010, 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, 2011 and 2010 was $197,000 and $211,000, respectively.

Contingencies

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

10. RELATED PARTY TRANSACTIONS

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

11. SEGMENT AND MAJOR CUSTOMER INFORMATION

The Partnership's operations are classified into three segments: Fee Timber, Timberland Management & Consulting, and Real Estate. The Fee Timber segment consists of the harvest and sale of timber from 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, 2011. All of the Partnership's real estate activities are in the State of Washington.

For the year ended December 31, 2011, the Partnership had one customer that represented 28% of consolidated revenue, or $16.2 million. For the year ended December 31, 2010, the Partnership had one customer that represented 24% of consolidated revenue, or $7.6 million. 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.

Identifiable assets are those used exclusively in the operations of each reportable 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 by the chief operating decision maker. 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)	**2011**	2010	2009
Revenue			
Partnership Fee Timber	**$31,429**	$22,474	$14,977
Funds Fee Timber	**21,749**	5,370	31
Total Combined Fee Timber	**53,178**	27,844	15,008
Timberland Management & Consulting	**2,390**	1,519	1,509
Real Estate	**4,593**	3,535	5,078
Total Revenue (Internal)	**60,161**	32,898	21,595
Elimination of Intersegment Revenue	**(2,887)**	(1,706)	(1,117)
Total Revenue (External)	**$57,274**	$31,192	$20,478
Intersegment Revenue or Transfers			
Partnership Fee Timber	**($449)**	($170)	($161)
Funds Fee Timber	**–**	–	–
Total Combined Fee Timber	**(449)**	(170)	(161)
Timberland Management & Consulting	**(2,390)**	(1,488)	(908)
Real Estate	**(48)**	(48)	(48)
Total Intersegment Revenue or Transfers	**($2,887)**	($1,706)	($1,117)
Operating Income (Loss)			
Partnership Fee Timber	**$13,965**	$9,657	$4,131
Funds Fee Timber	**942**	(1,307)	(1,185)
Total Combined Fee Timber	**14,907**	8,350	2,946
Timberland Management & Consulting	**429**	55	355
Real Estate	**(301)**	(761)	1,711
G&A	**(4,188)**	(4,731)	(3,733)
Total Operating Income (Internal)	**$10,847**	$2,913	$1,279

(in thousands)	**2011**	2010	2009
Intersegment Charges or Transfers			
Partnership Fee Timber	**($398)**	($119)	($113)
Funds Fee Timber	**2,390**	1,472	891
Total Combined Fee Timber	**1,992**	1,353	778
Timberland Management & Consulting	**(1,944)**	(1,305)	(730)
Real Estate	**(48)**	(48)	(48)
G&A	**–**	–	–
Total Intersegment Charges or Transfers	**–**	–	–
Total Operating Income (External)	**$10,847**	$2,913	$1,279
Depreciation, Amortization and Depletion			
Partnership Fee Timber	**$3,460**	$2,883	$2,413
Funds Fee Timber	**8,602**	2,534	–
Total Combined Fee Timber	**12,062**	5,417	2,413
Timberland Management & Consulting	**8**	3	17
Real Estate	**405**	240	190
G&A	**134**	151	191
Total	**$12,609**	$5,811	$2,811
Assets			
Partnership Fee Timber	**$52,886**	$54,990	$57,982
Funds Fee Timber	**139,389**	146,803	89,531
Total Combined Fee Timber	**192,275**	201,793	147,513
Timberland Management & Consulting	**3**	10	38
Real Estate	**35,913**	31,757	30,604
G&A	**2,217**	2,277	8,925
Total	**$230,408**	$235,837	$187,080
Capital and Land Expenditures			
Partnership Fee Timber	**$998**	$524	$532
Funds Fee Timber	**837**	58,311	34,553
Total Combined Fee Timber	**1,835**	58,835	35,085
Timberland Management & Consulting	**3**	2	–
Real Estate – development activities	**4,104**	1,075	1,639
Real Estate – other	**168**	185	537
G&A	**63**	125	23
Total	**$6,173**	$60,222	$37,284
Revenue by product/service			
Domestic forest products	**$27,227**	$18,384	$12,016
Export forest products, indirect	**25,502**	9,290	2,831
Conservation easements and sales	**2,435**	2,400	3,298
Fees for service	**–**	31	632
Homes, lots, and undeveloped acreage	**2,110**	1,087	1,701
Total	**$57,274**	$31,192	$20,478

12. 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
2011					
First quarter	**$17,674**	**$4,762**	**$3,680**	**$0.82**	**$0.82**
Second quarter	**14,269**	**3,460**	**3,287**	**0.73**	**0.73**
Third quarter	**7,522**	**(766)**	**(562)**	**(0.14)**	**(0.14)**
Fourth quarter	**17,809**	**3,391**	**2,349**	**0.52**	**0.52**
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

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, 2011 and 2010, and the related consolidated statements of operations, partners' capital, and cash flows for each of the years in the three-year period ended December 31, 2011. 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, 2011 and 2010, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2011, 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, 2011, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 9, 2012 expressed an unqualified opinion on the effectiveness of the Partnership's internal control over financial reporting.

/s/ KPMG LLP
Seattle, Washington
March 9, 2012

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, 2011, 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 "Management's Report on Internal Control Over Financial Reporting" in the Partnership's annual report on Form 10-K. 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, 2011, 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, 2011 and 2010, and the related consolidated statements of operations, partners' capital, and cash flows for each of the years in the three-year period ended December 31, 2011, and our report dated March 9, 2012, expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP
Seattle, Washington
March 9, 2012

Results of Operations

(Dollar amounts are in thousands except per unit data)	**2011**	2010	2009	2008
Revenue				
Fee Timber	**$52,729**	$27,674	$14,847	$23,551
Timberland Management & Consulting	**0**	31	601	944
Real Estate	**4,545**	3,487	5,030	3,683
Total revenue	**57,274**	31,192	20,478	28,178
Operating income/(loss)				
Fee Timber	**16,899**	9,703	3,724	6,294
Timberland Management & Consulting	**(1,515)**	(1,250)	(375)	(543)
Real Estate	**(349)**	(809)	1,663	(1,111)
General & Administrative	**(4,188)**	(4,731)	(3,733)	(3,951)
Total operating income	**10,847**	2,913	1,279	689
Depreciation, depletion, and amortization	**12,609**	5,843	2,811	4,689
Net interest expense/(income)	**1,684**	1,144	1,007	225
Income tax expense/(benefit)	**236**	(290)	39	(61)
Debt extinguishment costs	**–**	1,250	1,137	–
SLARS impairment and loss or gain on dispositions	**–**	(11)	318	381
Noncontrolling interests	**173**	(1,218)	(950)	(1,018)
Net income/(loss)	**8,754**	2,038	(272)	1,162
PER DILUTED UNIT RESULTS				
Net income/(loss)	**$1.94**	$0.43	($0.07)	$0.23
Distributions	**1.20**	0.70	0.70	1.60
Partners' capital	**17.27**	16.40	18.17	18.83
Weighted average diluted units outstanding (000)	**4,325**	4,578	4,539	4,661
CASH FLOW				
Net cash provided by operating activities	**$21,660**	$8,950	$662	$3,952
Distributions to unitholders	**5,263**	3,241	3,219	7,444
Unit repurchases	**0**	12,267	1,838	3,940
Payment/(issuance) of long-term debt, excluding debt-issuance costs	**4,673**	(21,008)	97	1,342
Free cash flow#	**18,641**	4,894	(1,615)	1,957
FINANCIAL POSITION				
Land and timber, net of depletion	**$216,779**	$226,678	$171,401	$137,133
Total assets	**230,408**	235,837	187,080	165,411
Long-term debt, including current portion	**45,825**	50,498	29,490	29,586
Partners' capital	**75,759**	70,990	83,126	87,817
FINANCIAL RATIOS#				
Total Debt to Total Capitalization	**33%**	37%	26%	25%
Return on Equity	**12%**	3%	0%	1%
Enterprise value / EBITDDA	**13**	26	34	31
UNIT TRADING PRICES#				
High	**$50.29**	$38.61	$28.98	$43.81
Low	**35.02**	23.32	15.61	15.00
Year-end close	**42.99**	36.80	24.60	20.00
Market capitalization (year end – $millions)	**189**	159	113	93
Enterprise value (year end – $millions)	**212**	168	121	153
Fee timber harvest (MMBF)	**90**	53	32	38
Average per MBF log revenue	**567**	486	410	506
Employees at December 31 (full time equivalent)#	**45**	45	42	51

Unaudited

2007	2006	2005	2004	2003	2002	2001
$35,514	$35,260	$44,424	$33,571	$22,916	$23,298	$24,999
1,344	3,670	7,764	1,601	2,386	7,295	9,703
15,037	27,320	4,818	4,476	1,734	1,599	13,143
51,895	66,250	57,006	39,648	27,036	32,192	47,845
15,215	14,592	16,320	15,126	9,669	10,199	9,190
(883)	1,266	3,540	(598)	272	919	1,685
5,163	13,864	1,270	1,586	(476)	(1,667)	(2,709)
(4,782)	(3,817)	(3,651)	(2,986)	(2,842)	(3,864)	(5,110)
14,713	25,905	17,479	13,128	6,623	5,587	3,056
5,549	7,017	11,252	5,752	3,546	3,864	7,698
(324)	625	2,477	2,952	2,806	2,894	2,961
(69)	439	997	–	242	(788)	356
–	–	–	–	–	–	–
–	–	–	–	–	–	–
(402)	(69)	321	–	47	147	171
15,508	24,910	13,684	10,176	3,528	3,334	(432)
$3.22	$5.22	$2.88	$2.22	$0.78	$0.74	($0.10)
1.36	1.06	0.80	0.44	0.24	0.10	–
20.48	18.70	14.29	12.01	10.19	9.65	8.98
4,769	4,762	4,753	4,594	4,522	4,520	4,526
$12,113	$33,114	$23,950	$16,485	$8,029	$8,900	$11,235
6,449	4,961	3,701	1,989	1,084	452	–
1,374	–	–	–	–	–	–
1,481	1,675	1,883	1,979	1,662	1,110	(26,540)
11,268	25,784	16,731	10,898	3,595	4,119	2,588
$138,112	$133,731	$78,222	$87,517	$69,003	$70,495	$71,549
179,325	180,282	106,358	94,868	86,308	86,788	84,187
30,727	32,208	33,883	35,766	37,745	39,239	39,667
96,644	87,605	66,405	54,533	46,036	43,598	40,673
24%	27%	34%	40%	45%	47%	49%
17%	32%	23%	20%	8%	8%	-1%
9	5	5	7	9	10	10
$50.01	$36.00	$56.85	$25.25	$15.99	$15.50	$24.50
34.25	30.00	19.35	15.00	7.00	9.30	14.00
42.75	34.32	31.02	25.00	15.43	10.11	14.75
202	161	144	113	70	46	67
181	160	154	123	88	92	110
55	55	74	60	45	45	36
607	611	576	529	476	488	503
58	60	65	49	48	79	123

Free cash flow = net income plus depreciation, depletion, amortization, and cost of land sold less required principal payments and capital expenditures (excluding timberland acquisitions and Poulsbo office building).

Enterprise value = average of year-end market capitalization less cash plus debt outstanding for current and prior year. Only 20% of Fund debt and cash is included in calculation.

Unitholder Information

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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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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:

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