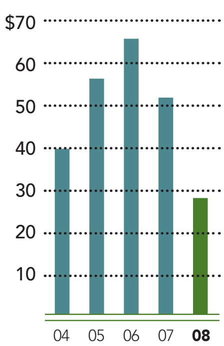
pope resources

2008 ANNUAL REPORT

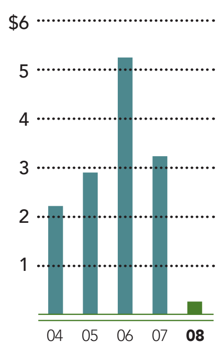
financial highlights

(thousands, except per unit data)	**2008**	2007	2006
Revenue			
Fee Timber	**$23,551**	$35,514	$35,260
Timberland Management & Consulting	**944**	1,344	3,670
Real Estate	**3,683**	15,037	27,320
Total revenue	**$28,178**	$51,895	$66,250
Income/(loss) from operations			
Fee Timber	**$6,294**	$15,215	$14,592
Timberland Management & Consulting	**(543)**	(883)	1,266
Real Estate	**(1,111)**	5,163	13,864
Administrative	**(3,951)**	(4,782)	(3,817)
Total income from operations	**$689**	$14,713	$25,905
Net income	**$1,162**	$15,508	$24,910
Net income per fully diluted unit	**$0.25**	$3.21	$5.23
Free cash flow	**$1,957**	$11,268	$25,784
Free cash flow per fully diluted unit	**$0.42**	$2.34	$5.41
Unit price at year-end	**$20.00**	$42.75	$34.32
Distribution per unit	**$1.60**	$1.36	$1.06
Units outstanding at year-end	**4,599**	4,663	4,647
Total assets	**$165,411**	$179,325	$180,282
Long-term debt, including current portion	**29,586**	30,727	32,208
Minority interest – IPMB	**3**	3	77
Minority interest – ORM Timber Fund I, LP	**44,354**	45,803	46,685
Partners' capital	**87,817**	96,644	87,605
Partners' capital per unit	**$19.09**	$20.73	$18.85
Fee timber harvest (MMBF)	**37.7**	55.1	54.5

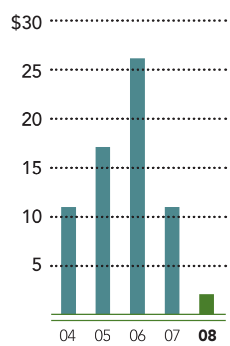
Total Revenue
millions



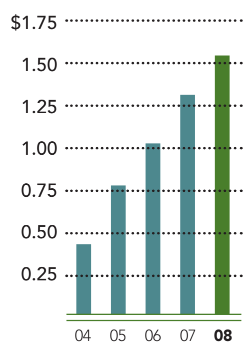
Earnings Per Diluted Unit



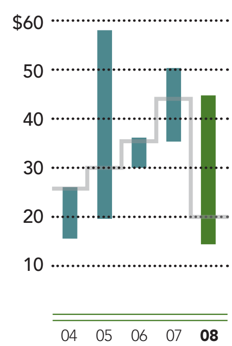
Free Cash Flow
millions



Distribution Per Unit



Unit Trading Range
close



dear fellow unitholders,

There is no sugar coating the fact that we are in the middle of the worst recession in a generation. Our 2008 results reflect the impact of this recession on our current operations and expectations for the future. This letter will explain what management is doing to conserve the strong balance sheet that we have built up over the past several years and our efforts to capitalize on the opportunities that this crisis will inevitably create.

The markets for logs and land are currently experiencing a "perfect storm" of constrained credit markets, weak employment, rattled consumer confidence, and declining home and real estate values that have produced the lowest housing starts since economists began compiling that data 50 years ago. We knew 2008 was going to be a tough year as housing starts began to slow early in the year, but the severity of the housing downturn and the resulting impact on our own markets for logs and land has gone beyond our expectations.

Our financial performance declined dramatically this past year, with revenue down 46% from 2007 to a total of $28 million, the lowest level since 2003. Net income for the year, at $1.2 million, or $0.25 per diluted ownership unit, was down significantly from the levels we've enjoyed the prior four years and was the lowest since the partnership suffered losses in 2000–2001 associated with the sale of the Port Ludlow resort operations.

It is important to note while digesting all these grim numbers, that a good portion of the decline in our financial performance stemmed from our decision in late 2007 to reduce our 2008 harvest volume to well below our long-term sustainable harvest level. Our total 2008 log harvest volume, which includes the consolidated results of ORM Timber Fund I, LP, totaled 38 million board feet (MMBF). This was 32% below the 55 MMBF we harvested in 2007 and almost 30% below our current estimate of the long-term sustainable harvest level of 52 MMBF. Our ability to defer harvest volume is based on a belief that, from a net present value standpoint, we are adding value to our timberland portfolio through allowing the deferred volume to grow in quantity and quality until the point when log prices recover.

As we move into 2009, we have decided again to defer harvest volume, announcing a similar level of harvest reduction as we did in 2008. The ability to defer harvest volume is a function, in part, of the unique attributes associated with timber to continue to grow in volume and value when it is not harvested. It is also due to our operational structure with no mills to feed, a conservative balance sheet with modest debt in relation to the value of our assets, a healthy cash balance, ample borrowing capacity, and a focus on long-term value-adding activities.

Given the near certainty of weak product markets for 2009 and the possibility that the current recession will last well into next year, the main thrust of this year's letter will focus on how we will not just preserve, but add to, the company's value during this cyclical downturn. We will examine our approach to capital allocation as well as take a closer look at the strategies of each of our three business segments. I want to provide fellow unitholders with a sense of how we are managing through this recession as well as how we are prepared for the possibility of it lasting much longer than anticipated.

Capital allocation strategies

Pope Resources was well positioned during the most recent cyclic upturn to generate significant free cash flow. This was done through a concerted effort during the early part of this decade to invest in our real estate portfolio to create a "pipeline" of readily salable lots. We were also fortunate to make three small timberland acquisitions which had significant volumes of merchantable timber ready to be harvested. Along with strong pricing in both logs and land, these actions allowed us to generate, excluding capital used to acquire timberlands either outright or through co-investment in our timber fund, $65 million of free cash flow over the four years from 2004 to 2007. This "harvest" of free cash flow afforded us the luxury of simultaneously growing our asset base, buying back 3% of our units on the open market, and returning more capital to unitholders in the form of higher distributions.

While much of this capital was readily put to good use, some was set aside for what we saw as an inevitable downturn in our primary markets. Unfortunately, much of our "excess" capital was invested in student loan auction rate securities (SLARS). These financial instruments were essentially bundles of federally backed student loans that were re-priced each month in short-term auctions. As such, they behaved as short-term investments with long-term yields. This all changed in early 2008 when the short-term auctions failed to attract enough buyers and holders of these securities suddenly found themselves holding essentially illiquid assets as auctions failed. Pope Resources, like many other companies holding such securities, spent considerable time over the past year trying to extricate itself from this situation. When the recurring auction system failed in early 2008, we held nearly $17 million of these securities. A combination of redemptions and a settlement between one of our banks and state regulators allowed management to recover $13 million of our SLARS balance at par, leaving us with a $4 million par value balance. We hope to completely exit our SLARS position by mid-year following the resolution of an arbitration case.

Notwithstanding the requirement during 2008 to reclassify our SLARS portfolio as a long-term asset, Pope Resources has maintained significant cash reserves throughout the past year. By year-end 2008, our total cash position, excluding cash balances of the two timber funds, stood at $16 million. However, with the closing of our second timber fund in March 2009, we have a capital co-investment commitment of just under $17 million. We expect this co-investment commitment to be spread out over the next two years, and we are largely in control of the timing of that obligation, but it still represents a substantial capital obligation both in absolute terms and relative to our cash position. For this reason, as well as to create a cushion in the event that the current recession lasts considerably longer than expected, we entered into a $40 million revolving line of credit in 2008. We believe this revolver, which remains untapped, will provide us with both operational flexibility as well as the opportunity to capitalize on potential investment opportunities.

Having addressed the supply of capital, let's turn our attention to the deployment of that capital. The five primary uses of capital for Pope Resources include timber fund co-investment, purchasing timberland properties directly, investing in our real estate portfolio, returning capital to our unitholders through quarterly distributions, and repurchasing units. I will address each of these areas in more detail.

TIMBER FUND CO-INVESTMENT – This continues to be our primary vehicle for growing the partnership's timberland base over the long term. Assuming the second timber fund becomes fully invested during its two-year drawdown period, Pope Resources' co-investment capital will total nearly $29 million between our first two funds. Our co-investment was 20% for both of our first two funds, but may not necessarily stay at this level for future funds. If we are not generating sufficient free cash flow in the future, we will consider lowering our co-investment percentage on future timber funds.

I will also caution readers that having a closed fund does not guarantee that we will fully deploy our co-investment capital. The current timberland market remains fully priced in our view and does not reflect either lower current log prices or changes in perceived risks going forward. We believe that prices for timberland should fall over the next few years, and are positioning our second fund to be able to take advantage of this expectation.

PURCHASING TIMBERLAND DIRECTLY – While the timber funds are our primary timberland investment vehicle, we are permitted under the funds' governing agreements to acquire small tracts that are adjacent to our existing tree farms. We have been successful, over the past five years, in acquiring nearly 6,000 acres near our Hood Canal and Columbia tree farms. We generally pursue such transactions on an opportunistic basis.

INVESTING IN REAL ESTATE PORTFOLIO – Strategically, we view our real estate portfolio as more of a supplier than consumer of capital. However, in order to "harvest" this value, we also have to make investments in entitlements and, in some cases, project infrastructure such as roads, sewer and water lines, and access to utilities. These investments in our larger projects in Gig Harbor and Bremerton can be seen in our balance sheet under the "land held for development" line item, which has grown significantly over the past five years. We expect that our ongoing efforts to complete the entitlements on these projects will help "unlock" the value of these investments made in recent years and deliver significant "harvests" of free cash flow in the future.

Notwithstanding the current downturn in the housing market, we remain committed to investing in our real estate portfolio. As we did during the last recession in 2001–2002, we are trying to position ourselves for the next cyclic upturn by having product ready to sell. Given the current depressed market conditions, many competing developers and homebuilders in our region are cutting back on their lot entitlement and permitting efforts. We believe that when credit markets turn around and excess home inventories are drawn down, many of these players will not have product ready to sell. We are positioning ourselves to take advantage of that situation by making investments today to complete two large residential plats that are in the permitting pipeline in Gig Harbor and Kingston. These efforts will take at least another year to complete, but we believe they will position us well for the point in time when markets improve.

QUARTERLY UNIT DISTRIBUTIONS – We have made a concerted effort over the past six years to increase our quarterly distribution, both to remain competitive with other publicly traded timber equities and to pay out a proportion of the free cash flow generated by our timber and real estate activities. Historically, we have not paid out all of our free cash flow generated from our fee timber and real estate holdings, but instead have used a portion to fund growth in our timberland ownership, real estate entitlement efforts, and start-up costs and co-investment commitments for our timber fund business.

We have recently announced a significant reduction in our quarterly distribution from 40 cents per unit in the fourth quarter of 2008 to 20 cents in the first quarter of 2009. The current economic environment for our log and raw land markets is severely depressed. If we expected these markets to rebound quickly, then it might make sense to continue distributions at recent levels. But the Board and management believe that we may be looking at a protracted housing downturn and, as such, wanted to act quickly and prudently to conserve cash. This was the primary driver behind the decision to reduce the distribution level. We recognize that part of our lower cash flow is a function of the decision to reduce our harvest level below our long-term sustainable level, but we do not believe it is prudent to continue selling large volumes of logs into depressed log markets in order to maintain cash flows just to support our quarterly distribution.

Even at this reduced quarterly distribution level, we are not "earning our distribution" and this burns through cash balances in an unsustainable fashion. The level of future quarterly distributions will be subject to an ongoing review of the overall economy, cash flow generated by our operations, and the assumed prospects for resuming more "normal" log harvest volumes.

REPURCHASING UNITS – Based on the belief that our units were trading at values considerably below the underlying value of our assets, we announced a $5 million open-market unit repurchase program in November 2007. That repurchase program was completed ahead of schedule in April 2008 following exceptionally heavy trading volumes in the first quarter of last year. The timing of our repurchase program coincided with decisions in early 2008 by our two largest institutional unitholders, for different reasons, to sell significant portions of their holdings in Pope Resources. We repurchased approximately 2.7% of the total units outstanding with this program at an average cost of $38.90 per unit. Given the current unit price, one might argue that this was a destruction of unitholder value, but we feel that it nevertheless represents a significant discount to the intrinsic value of our units.

As we watched the unit value erode through the balance of 2008, we considered an additional $5 million open-market unit repurchase program. Our interest in another repurchase program intensified in early December with a spike in trading volume and a new 52-week low of $15 per unit. However, for the same reasons we cut our unit distribution level in half, namely to conserve cash, we also cut the size of this second unit repurchase program to $2.5 million. That unit repurchase program was announced in December 2008 and has been driven, in part, by our view that the unit price had been disproportionately influenced by the continued selling by our largest institutional unitholder.

Trading levels in recent months have not been as robust as a year ago, so we have made more modest progress in our most recent unit repurchase program. Through the end of the first quarter of 2009, we have completed roughly half the approved repurchase, buying back approximately 1.3% of total units outstanding at an average cost of $18.72 per unit. Notwithstanding this more modest progress, we believe the current unit price represents a significant buying opportunity and feel this justifies the use of our capital even in these turbulent economic times.

With the current recession translating to significantly reduced levels of free cash flow, we have been forced to prioritize among these discretionary capital investment alternatives. As described earlier, we have cut in half the size of our quarterly distribution and significantly scaled back the current unit repurchase program compared to the prior one. While we would like to increase the capital allocated to both these avenues, we are being cautious and waiting for signs of economic recovery. We have also greatly reduced our real estate capital expenditures, with entitlement efforts being the primary focus of our current capital deployment. We view our timber fund co-investment commitment as our primary long-term growth initiative. While we are not backing away from this commitment, we are also remaining firm in our conviction that timberland asset prices need to come down in order for us to meet our return threshold. As buyers for the timber fund, we continue to be disciplined in our underwriting standards and expect that it may take a year or more for prices to come down to the level we find attractive. With less free cash flow to invest, we are also taking a decidedly opportunistic approach to investing directly in timberlands adjacent to our existing tree farms. These capital allocation priorities are reviewed periodically and will be reassessed as we start to see signs of improved fundamentals in our timber and land markets.

Business segment strategies

Fee Timber

In past editions of this letter I have discussed the positive investment attributes of the timber asset class:

- As world economies grow in size and/or in per capita wealth, they use more forest products, which provide a strong basis to support current as well as future investments in timberland.
- Over the long term, the timber asset class has delivered compelling risk-adjusted returns with attractive diversification attributes.
- Timberland returns have historically been well correlated with inflation.

Notwithstanding the current economic downturn, our properties are poised to benefit from these value levers because they are located in one of the world's most highly productive timberland growing regions with a broad mix of competitive mills in the nation's top two lumber-producing states. The Pacific Northwest forest products industry is also well-situated to serve markets in the Pacific Rim such as Japan, Korea, and China and domestic markets both locally and throughout the western United States.

Owning timberland through a publicly traded partnership remains a highly tax efficient vehicle because profits associated with timber harvesting are treated as capital gains income, taxable today at 15%, while all other costs associated with managing the lands and the partnership are treated as ordinary expense and thus taxed at a unitholder's higher marginal tax rate. While the bottom line may indicate a profit, the interplay between the two tax rates applied to capital gain on the one hand and ordinary loss on the other can create a net tax benefit. The "tax yield" embodied in this net tax benefit is somewhat differential for each unitholder based on when their units were purchased but is nonetheless meaningful to investors.

While the long-term attributes of timber remain positive, all signs point to the current industry downturn as being one of the most severe in decades. Mills are curtailing or closing operations and we have, accordingly, already seen even weaker log prices in 2009 relative to 2008. In 2008 the average realized log price we earned was just over $500 per thousand board feet (MBF), 17% lower than 2007's average realization. While we expect further deterioration in log prices in 2009, we anticipate a less dramatic price decline than what was experienced last year. As described earlier, we plan to continue in 2009 with our reduced harvest program begun in 2008. We plan to harvest 37 MMBF of logs in 2009, a level that is almost 30% below our long-term sustainable harvest level of 52 MMBF. It is worth re-emphasizing that our strong balance sheet has afforded us this "luxury" of being able to "bank" value on-the-stump by allowing biological growth to add both volume and value to our timber while we wait for markets to improve.

In the meantime, we are not sitting idly by waiting for trees to grow and markets to rebound. We have a lean cost structure throughout our organization and while log harvest activity is throttled back, we are deploying freed-up forester time to get out in front of harvest unit permitting for future years, making further updates to our timber inventory database, and performing due diligence on timberland acquisition opportunities. In 2008 we closed on three acquisitions consisting in the aggregate of four small tracts for Pope Resources' account totaling 1,180 acres for $1.5 million ($1,266/acre). Three of the tracts are in-holdings, or purchases of lands adjacent to our existing properties, which we believe provide some incremental enhancement to the value of the partnership's surrounding land. The fourth tract represents a hold-and-sell opportunity sometime down the road.

Another effort that was made possible by freed-up timberland management resources was to pursue a land exchange with the Washington State Department of Natural Resources (DNR). In August 2008 we entered into a letter of intent with the DNR to explore a potential land exchange involving approximately 4,000 acres of our ownership in east Jefferson County. An exchange with the DNR, which is based on balancing values as determined by a third-party appraisal, allows both parties to gain management efficiencies by blocking up their respective ownerships. This exchange, if completed, will close in mid-2009.

Timberland Management & Consulting

Our third-party services business platform, originated 12 years ago with the launch of the Olympic Resource Management (ORM) brand, has generated significant revenue for the partnership over that span. Our ability to attract and retain outstanding talent to meet the service demands of this third-party business has been as significant in its own way as the revenue generated. Neither our own assets nor those of our clients could alone justify the retention of this staff. We continue to explore other opportunities to build on this platform of management success and extend the ORM brand.

In part as a way of maximizing the efficient use of this talent pool, as well as allowing us to deploy our own capital more efficiently, we have established a timber fund strategy in which we co-invest alongside third-party investors to acquire and manage timberlands in our market area. We are now seeking to actively deploy capital from our second fund, with an initial closing of $46 million in August 2008 and an additional closing of $38 million in March 2009 for a total of $84 million in committed capital. This committed capital balance includes our 20% co-investment of $17 million. Over time, as we are able to grow the size of this business, we expect that our unitholders will enjoy increased economies of scale, fee income from managing both the properties and the funds, and future carried interest participation fees if a particular fund delivers returns to investors above a pre-determined threshold. This stream of fee income helps to augment the return from our co-investment capital and makes our participation in the fund business all the more attractive from an overall company perspective. We believe the timing of this second timber fund could not be better as opportunities to acquire timberland are expected to increase dramatically while log and lumber markets continue to weaken.

As with our first timber fund, we will have a two-year drawdown period with which to invest the committed capital from this fund. While we are pleased to have closed this fund in the current private equity climate, we also recognize the challenges we will face in placing this capital at our target rate of return. For a number of years, there has been far more capital chasing timberland as an investment alternative than there have been quality timberland acquisition opportunities. We are seeing early signs that constrained access to debt financing combined with a weakening supply of investment capital may be leading to more attractive acquisition pricing. We continue to be a patient buyer, recognizing that our own capital is at stake along with that of our third-party investors. We also continue to place a premium on strong local knowledge and thorough due diligence in order to not only make good investments, but also to avoid paying too much for properties.

Real Estate

The lengthy time associated with both conversion of lands from timberland to real estate and securing development entitlements necessitates a long-term focus. So while current markets for land have slowed considerably, our focus is more squarely on the next business cycle. Looking beyond current real estate markets, we still have property with tremendous upside for producing sales revenue and profits in the future. We have thousands of acres of property located within a 30-mile radius of the growing Seattle-Tacoma metropolitan area. We are working to maximize the value of our properties in this geography and over the coming decades expect to gradually reduce our footprint in the west Puget Sound region and increase our footprint in outlying areas that are more purely timber and resource-based lands.

While approximately 75% of our 2,500-acre Real Estate portfolio is zoned for 5- to 80-acre lots and fits into a category of rural residential HBU properties, this is not the most valuable portion of our portfolio. The remaining 25% of our portfolio lies within urban growth boundaries as defined by Washington State's Growth Management Act (GMA). The GMA, which was enacted in 1990 and designed to prevent suburban sprawl, greatly increased residential densities for lands located within urban growth boundaries. Our projects in Gig Harbor, Bremerton, and Kingston all enjoy the higher density residential zoning associated with this GMA classification and collectively represent a pipeline of valuable residential, business park, and commercial parcels located within these urban growth areas.

We have 251 acres remaining in our Gig Harbor project that consists of a mix of 16 acres of commercial property, 32 acres of business park land, and 203 acres of residential land that ultimately can support 823 residential lots. We submitted a preliminary plat for the residential portion of this project in late 2008. The approval process is expected to take a few years to complete. We are currently marketing portions of the commercial and business park land to further enhance the "amenities" that will bring a return of value to the downstream residential portion of the project. Since we can not say with certainty what the duration of the current downturn will be, we have taken steps to realign our project-related expenditures to be consistent with an assumed stretching out of timelines and market readiness for lot absorption.

Our Bremerton project represents the inverse of our Gig Harbor project in that we sold out of the residential component first. We sold the 200-acre residential portion of the 264-acre mixed use project in 2006, and then completed infrastructure investments on the first phase of the 64-acre industrial park land and closed on two of 24 industrial lots during 2007. It was a sign of the falloff in commercial real estate that we did not sell any of these industrial lots in 2008. We have modest expectations for sales activity from this project in 2009. It is also worth noting that we are deferring infrastructure investments for the second phase of the industrial park until most of the nine lots in the first phase have been sold.

I reported in this letter last year that we submitted a preliminary plat application for our entire 751-lot project in Kingston as well as the detailed engineering drawings for the first two phases of construction totaling 245 residential lots. Kitsap County's review and processing of our application is proceeding on schedule for approval during 2009. We continue to believe this project will be well positioned when markets begin to improve.

PLAYING DEFENSE WITH 20-ACRE LOT SEGREGATIONS – Sometimes our most significant value-enhancing work involves playing defense. Two years ago, we caught wind that a county in southwest Washington was about to downzone 24,000 acres of our ownership from maximum lot sizes of 20 acres to 1,000 acres, essentially wiping out any future real estate value. In a defensive mode, we mobilized to submit a lot segregation of the entire 24,000 acres that we call our Swift Reservoir block into 1,183 20-acre lots just ahead of the anticipated downzone. We did not have specific development plans for this property, which is 40 miles as the crow flies from downtown Portland, Oregon. But when it comes to land, a long-term perspective is important and we knew that losing the 20-acre potential density would be a loss in value that would be difficult to reverse.

We began a dialogue with local community leaders and conservation interests about future uses for the 24,000-acre tract. In late 2008 we signed a letter of intent with the Columbia Land Trust (CLT) to sell development rights, through a conservation easement, covering 85% of our 24,000-acre ownership and preserving 15% for development of residential and recreation properties. The agreement with CLT is non-binding and essentially only outlines our mutual goals and provides a framework for a future financial transaction. It could take many years to complete the work that Pope Resources and the CLT have embarked on together. We believe this is an exciting opportunity and represents one of those proverbial "win-win" situations for all involved.

We are working on a similar defensive strategy in Kitsap County where we own 18,000 acres within a 30-mile radius of downtown Seattle. Most of these lands are currently used for timber production and will be used as such for many years to come. In February 2009 we recorded a subdivision on approximately 14,500 acres that segregated the property into 716 20-acre parcels. The subdivision was done in conformance with current zoning regulations that dictate a maximum density of one residential lot per 20 acres. This move reduces the need to look over our shoulders wondering when and if new rules will further downzone our land. The segregation will increase the "as-is" value of the land by creating saleable lots and enhance downstream opportunities to develop properties utilizing proposed clustering legislation.

"STRING OF PEARLS" INITIATIVE – In north Kitsap County, on an 8,000-acre subset of the aforementioned 18,000 acres, our real estate group has developed a project concept we call the "String of Pearls," which attracted considerable energy and support from State and local political leaders. The "pearls" are seven small waterfront towns and villages on or adjacent to the north Kitsap peninsula in west Puget Sound: Poulsbo, Hansville, Kingston, Indianola, Suquamish, Bainbridge Island, and Port Gamble. The "string" is a trail system that is partly in place to connect this collection of places but needs some work to perfect. To this end, the North Kitsap Trails Association, a non-profit group formed by the company to advance completion of the "string," has obtained a $60,000 grant from the National Park Service.

Land values in North Kitsap have grown well beyond those that justify continued "industrial" timber production. We have articulated three broad options for the long-term disposition of our 8,000-acre holding in North Kitsap, each with its own advantages and disadvantages for the company and the community. By far, the most complicated and ambitious of these three broad options is the "String of Pearls," which depends on a very real partnership between Pope Resources and the affected communities. The community gets more trails and open space while we get to develop portions of the property utilizing Kitsap County's proposed rural lot clustering program. The 20-acre lot segregation action mentioned above preserves an alternative for selling the land should the "String of Pearls" concept prove economically or otherwise infeasible. I encourage you to visit the String of Pearls website at www.nkstringofpearls.com to learn more.

Looking Ahead

These are very trying and uncertain times for our company and our industry as the nation's economy grapples with the housing crisis as well as a significant recession. As profound as the uncertainty is around how and when things will turn around, I am very confident that Pope Resources is well prepared to weather the storm and emerge on the other side poised for great things. Our fortitude and discipline as an organization will be tested, but I am confident that our strategies will bear fruit in the not-too-distant future.

My optimism is due in part to our management team and the broader group of employees that I am privileged to lead. I would also like to recognize the considerable contributions of our Board of Directors, who have helped guide our management team with the wisdom that comes from having been through many challenging business cycles. I am proud of the dedication and vision demonstrated by our employees, management, and Board. I hope this letter has been helpful to you, our unitholders, in better understanding our strategies and priorities for managing our way through these turbulent times. As always, I welcome your feedback regarding how you think we are doing and thank you for your continued interest in Pope Resources.

DAVID L. NUNES
President and Chief Executive Officer
April 14, 2009

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 the part of our 2008 10-K report entitled "Risk Factors". Other issues that may have an adverse and material impact on our business, operating results and financial condition include our ability to accurately estimate the potential for environmental remediation costs at Port Gamble; the impacts of natural disasters on our timberlands and on surrounding areas; credit and economic conditions that affect demand for our products; and environmental and land use regulations that limit our ability to harvest timber and develop property. 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"), was organized in late 1985 as a result of a spin-off by Pope & Talbot, Inc. ("P&T"). We are engaged in three primary businesses. The first, and by far most significant segment in terms of owned assets and operations, is the Fee Timber segment. This segment includes timberlands owned directly by the Partnership and operations of Fund I and to a lesser extent Fund II. Operations in this segment consist of growing timber to be harvested as logs for sale to domestic manufacturers and to a lesser extent export brokers. The second most significant business in terms of total assets owned is the development and sale of real estate. Real Estate activities primarily take the form of securing permits, entitlements, and, in some cases, installing infrastructure for raw land development and then realizing that land's value by the selling of larger parcels to buyers who will take the land further up the value chain, either to home buyers or to operators and lessors of commercial property. Since these land projects span multiple years, the Real Estate segment may incur losses for multiple years while a project is developed until that project is sold resulting in operating income. Our third business is raising and investing capital from third parties for private equity timber funds and managing the timberland owned by both these funds and unaffiliated owners.

As of December 31, 2008, we owned 114,000 acres of timberland in western Washington State plus 2,500 acres of real estate held for sale or development. Our third-party Timberland Management & Consulting services have historically been conducted in Washington, Oregon, and California.

Net income for the year ended December 31, 2008 totaled $1.2 million, or $0.25 per diluted ownership unit, on revenues of $28.2 million. For the corresponding period in 2007, net income totaled $15.5 million, or $3.21 per diluted ownership unit, on revenues of $51.9 million. For the year ended December 31, 2008, cash flow from operations was $7.4 million, compared to $22.0 million in 2007. Net loss for the quarter ended December 31, 2008 totaled $1.4 million, or $0.31 per ownership unit, on revenues of $3.2 million. This compares to net income of $6.3 million, or $1.30 per diluted ownership unit, on revenues of $17.6 million for the quarter ended December 31, 2007. Fourth quarter 2007 results include a $1.9 million charge for environmental remediation at Port Gamble.

Our revenues, net income and cash flows are lower than in recent years owing largely to the well-publicized macroeconomic factors that have resulted in a dramatic reduction in housing starts in the United States, and to a much lesser degree in Japan; interest rates; overseas shipping rates; and currency exchange rates, particularly those between the United States and Canada, Japan, and Europe. Credit markets also have a significant impact on our business as our customers rely on those markets for liquidity. Housing starts, interest rates, and credit markets reflect or influence the health of the U.S. housing market. Currency exchange rates influence the competitiveness of our domestic sawmill customers as it relates to imported lumber from Canada, Europe, or the Southern Hemisphere as well as with the competitiveness of our logs in export markets in Asia. Our export logs are sold to domestic intermediaries who then export the logs. A favorable US$/yen exchange rate can help these intermediaries compete in the Japanese market with logs that originate from Canada, Russia, or the Southern Hemisphere, thus increasing the price that we are able to realize from the sale of this export-quality log volume.

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 market factors so that they 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. Log markets will in turn be affected by what is happening in the lumber spot markets, but pricing shifts typically adjust monthly rather than daily. Log price volatility is also moderated because logs are used to produce products besides just lumber (especially pulp). The market for timberland tends to be less volatile with pricing that lags both lumber and log markets. This is a function of the longer time horizons utilized by timberland investors where the short-swing fluctuations of log or lumber prices become stabilized in acquisition modeling. We watch the lumber market because activity there can presage log price changes. We are in the log market constantly as we negotiate delivery prices to our customers. The timberland market is important as we are constantly evaluating our own portfolio and its underlying value as well as the opportunities to adjust that portfolio through either the acquisition or disposition of such land.

Management's major opportunity and challenge is to grow our revenue base profitably. Our current strategy for adding timberland acreage is centered on our timber fund business model. For example, Fund I acquired 24,000 acres of timberland in late 2006 and we are currently looking to acquire properties for Fund II. Each of these funds is owned 20% by the Partnership and we earn both an asset management and on-the-ground timberland management fee from managing these timberlands. Our real estate challenges center around how and when to "harvest" a parcel of land and capture the optimum value increment by selling the property.

Our consolidated revenue in 2008, 2007, and 2006, on a percentage basis by segment, is as follows:

Segment	**2008**	2007	2006
Fee Timber	**84%**	68%	53%
Timberland Management & Consulting	**3%**	3%	5%
Real Estate	**13%**	29%	42%

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

Outlook

We expect 2009 revenue and income to decline from 2008 due to weakness in domestic housing starts and declines in the real estate and credit markets both of which impact the Fee Timber and Real Estate segments. Our strong balance sheet provides us the opportunity to defer timber harvest and land sales until these markets improve, and management has announced an intention to take that action, reducing our forecasted timber harvest for 2009 by approximately 30% from what we consider to be our sustainable harvest level. We also plan to look for opportunities to acquire timberland through Fund II at favorable prices during the current market weakness.

We plan to harvest 37 MMBF in 2009 which represents a 30% decline from our estimated sustainable harvest of 52 MMBF. The decision to defer harvest was made in response to our expectation of continued weakness in log markets resulting from the slowdown in housing starts that is associated with widely publicized declines in the credit and housing markets. In addition to the planned 32 MMBF harvest from our own lands, we plan to harvest 5 MMBF from Fund I tree farms in 2009. This represents a 42% reduction from the Fund I sustainable harvest level of 8 MMBF. Revenue generated by Fund I and Fund II is consolidated into the Partnership's financial statements. The 80% interest in the Funds owned by third-party investors is reported beneath operating income and is labeled Minority Interest. When speaking to inventory, volumes are expressed in millions of board feet, or "MMBF", while elsewhere in the document, volumes harvested are expressed in thousands of board feet, or "MBF".

We are also anticipating a decrease in Real Estate operating income, as the market for developable land is expected to remain extremely weak in the Pacific Northwest. Until the market improves, we expect to concentrate our Real Estate activities primarily on preparing properties for sale through obtaining valuable entitlements and completing infrastructure improvements.

We are currently reviewing General & Administrative and other costs across our business units in an effort to reduce expenses in response to this historic recessionary period. As a result of these cost reducing efforts, General & Administrative costs in 2009 are expected to decline relative to 2008.

RESULTS OF OPERATIONS

The following table reconciles net income for the years ended December 31, 2008 to 2007 and 2007 to 2006. 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 *(Amounts in thousands except per unit data)*	**2008 vs. 2007 Total**	2007 vs. 2006 Total
Net income:		
Year ended December 31, 2008	**$1,162**	
Year ended December 31, 2007	**15,508**	$15,508
Year ended December 31, 2006		24,910
Variance	**$(14,346)**	$(9,402)
Detail of earnings variance:		
Fee Timber		
Log price realizations [(A)]	**$(3,783)**	$(219)
Log volumes [(B)]	**(10,600)**	440
Harvest & haul	**3,600**	(1,203)
Depletion	**1,355**	1,580
Other Fee Timber	**474**	19
Timberland Management & Consulting		
Management fee changes	**(176)**	(433)
Disposition fees	**–**	(1,343)
Other Timberland Management & Consulting	**548**	(373)
Real Estate		
Development property sales	**(7,510)**	(7,409)
Environmental remediation	**1,878**	(1,618)
Timber depletion on HBU sale	**(478)**	–
Other Real Estate	**(164)**	330
General & Administrative costs	**831**	(965)
Interest expense	**239**	470
Other (taxes, minority interest, interest income)	**(560)**	1,322
Total change in earnings	**$(14,346)**	$(9,402)

(A) Price variance allocated based on changes in price using the current period volume.

(B) Volume variance allocated based on change in sales volume and the average log sales price for the prior period less variance in log production costs.

Fee Timber

REVENUE AND OPERATING INCOME

Fee Timber revenue is earned primarily from the harvest and sale of logs from the Partnership's 114,000 acres of fee timberland located in Western Washington and, to a lesser extent, from the lease of cellular communication towers together with the sale of gravel and other forest products that result from timberland operations. Revenue from the sale of timberland tracts will also appear periodically in results for this segment. Our Fee Timber revenue is driven primarily by the volume of timber harvested and by the average prices realized on log sales. In late 2006, Fund I acquired 24,000 acres of timberland with operating activities from these properties beginning in 2007 and 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, 2008, are as follows (all dollar amounts in millions, harvest volume in thousand board feet).

Year ended *(in millions)*	**Log Sale Revenue**	**Mineral, Cell Tower & Other Revenue**	**Total Fee Timber Revenue**	**Operating Income (loss)**	**Harvest Volume (MBF)**
2008 Pope Resources Timber	**$16.7**	**$2.0**	**$18.7**	**$ 6.7**	**32,455**
Fund I	**2.4**	**2.4***	**4.8**	**(0.4)**	**5,293**
Total	**$19.1**	**$4.4**	**$23.5**	**$6.3**	**37,748**
2007 Pope Resources Timber	$30.5	$2.0	$32.5	$14.8	49,825
Fund I	3.0	–	3.0	0.4	5,336
Total	$33.5	$2.0	$35.5	$15.2	55,161
2006 Pope Resources Timber	$33.3	$2.0	$35.3	$14.6	54,533
Fund I	–	–	–	–	–
Total	$33.3	$2.0	$35.3	$14.6	54,533

**Conservation easement sale revenue*

Fiscal Year 2008 compared to 2007. Revenue and operating income decreased in 2008 from 2007 due to a combination of reduced harvest volume and lower log prices partially offset by a $2.4 million conservation easement sale from Fund I. We planned to decrease our harvest volume in 2008 from 2007 in response to weak log markets. The decline in log prices is due to weak housing and credit markets experienced in 2008. Harvest volume in 2008 decreased 32% from 2007. Average log prices decreased $101 per MBF, or 17%, from log prices realized in 2007. Operating income in 2008 attributed to the Fee Timber segment decreased $8.9 million, or 59% from 2007.

The conservation easement sale completed by Fund I is accounted for in the Fee Timber segment due to our policy of including all operations of Fund I and Fund II in the Fee Timber segment. Conservation easement sales and land sales from the Hood Canal and Columbia tree farms made to buyers that plan to use the land for purposes other than timber production are accounted for in the Real Estate segment.

Fiscal Year 2007 compared to 2006. Revenue and operating income increased modestly in 2007 from 2006. The increase in revenue was due to an increase in harvest volume partially offset by a decline in average price realized. Harvest volume in 2007 increased 1% from 2006 and includes 5,336 MBF harvested by Fund I. The increase in harvest volume was offset in part by a decline in average log prices of $4 per MBF, or 1%, from log prices realized in 2006. Operating income in 2007 attributed to the Fee Timber segment increased $623,000, or 4%, from 2006. This increase was due primarily to a decline in depletion expense in 2007 from 2006. Harvest volume in 2006 included 6,851 MBF from a separate depletion pool that carried a higher depletion rate than our other depletion pools.

LOG VOLUME

Log volume sold for each year in the three-year period ended December 31, 2008 is as follows:

Volume *(in MBF)*	**2008**	**% Total**	2007	% Total	2006	% Total
Sawlogs						
Douglas-fir	**24,913**	**66%**	35,114	64%	38,954	71%
Whitewood	**3,121**	**8%**	6,492	12%	3,800	7%
Cedar	**795**	**2%**	2,238	4%	1,075	2%
Hardwoods	**977**	**3%**	2,733	5%	3,591	7%
Pulp						
All Species	**7,942**	**21%**	8,584	15%	7,113	13%
Total	**37,748**	**100%**	55,161	100%	54,533	100%

Log volume decreased 32% in 2008 from the 2007 harvest as management sought to reduce volume and preserve our asset value while log, lumber, and housing markets continued to decline throughout 2008. Spot markets developed at times during the year for pulp and export quality Douglas-fir and white woods. We took advantage of these spot markets when available but most log markets were extremely weak during the year. Pulp prices also weakened as 2008 progressed due in part to a surge of available supply of whitewood pulp logs resulting from salvage logging of timber stands damaged in a December 2007 storm event.

Log volume increased 1% in 2007 from the 2006 harvest. With the weakened market for Douglas-fir sawlogs, as a direct result of the soft housing market, we focused 2007 harvest on units with less Douglas-fir volume and more whitewood, cedar, and pulp. This allowed us to take advantage of those selected log markets that remained relatively strong. The export markets for high quality whitewood sawlogs strengthened in 2007 as log exporters were able to identify low cost opportunities to ship logs to Korea. The market for pulp and cedar strengthened as supplies declined. This is a common occurrence during weak log and lumber markets. Wood chips used to manufacture pulp are a by-product of lumber manufacturing so when mills reduce production, fewer wood chips are created thus increasing demand for pulp logs.

LOG PRICES

We have categorized our sawlog volume by species, which is a significant driver of price realized as indicated by the table below. The average log price realized by species for each year in the three-year period ended December 31, 2008, is as follows:

Price *(in MBF)*	**2008**	**% Change**	2007	% Change	2006
Sawlogs					
Douglas-fir	**$537**	**-14%**	$621	-7%	$669
Whitewood	**412**	**-11%**	462	4%	445
Cedar	**1,245**	**-3%**	1,280	17%	1,093
Hardwoods	**638**	**-31%**	931	37%	681
Pulp					
All Species	**359**	**-6%**	381	42%	268
Overall					
All Species	**506**	**-17%**	607	-1%	611

Douglas-fir: Douglas-fir is noted for its structural characteristics that make it generally preferable to other softwoods and hardwoods for the production of construction grade lumber and plywood. Demand and price for Douglas-fir sawlogs is very dependent upon the level of new home construction. As construction starts have declined significantly, we have experienced a 14% decline in Douglas-fir sawlog prices in 2008 from 2007 on top of a 7% decline in 2007 from 2006.

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 and plywood. Beginning midway through the second quarter of 2008 large volumes of storm-damaged whitewood entered the market as operations got underway to salvage logs that were blown down in a major windstorm that hit coastal Washington in late 2007. This influx of salvage material depressed both the export and domestic markets for whitewood. These same factors combined with the depressed housing markets served to bring down the average price realized on whitewood 11% in 2008 from 2007 versus an increase of 4% in 2007 from 2006.

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 decreased in 2008 versus 2007 by 3% versus a 17% increase in 2007 over 2006. The strong price realized for 2007 and 2006 reflects a general decline in cedar volume available in the Puget Sound area with resultant upward pressure on price due to continuing demand for such logs. The decline in 2008 reflects the decrease in home remodeling activity in concert with weakened credit and real estate markets.

Hardwood: "Hardwood" can refer to many different species, but on our tree farms primarily consists of red alder. The local mills that process alder sawlogs are using the resource to manufacture lumber for use in furniture and cabinet construction. In past years, the price realized from the sale of red alder sawlogs increased in connection with relatively limited supply, coupled with increased demand as a result of new mills focused on hardwood lumber production in the Pacific Northwest. However, the demand for alder lumber has been blunted as users have substituted other species in the face of higher alder prices. The effect of this substitution, combined with weakness in demand for end-use products has translated to lower prices and explains why the year-over-year price realized for hardwood log prices decreased 31% from 2007 versus an increase of 37% in 2007 from 2006. Hardwood represents a relatively minor species in our sales and timber inventory mix and only produces a small impact on overall revenue and earnings.

Pulp: Pulp 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 price realized from the sale of pulp logs is primarily driven by local pulp log inventories. Pulp prices in 2008 were down 6% from 2007 versus a 42% increase in 2007 over 2006. Pulp log prices were volatile during 2008 as pulp shortages caused by a decline in lumber mill activities resulted in an increase in demand for log prices in early 2008 followed by a dramatic increase in supply in the latter half of the year as salvage logging of coastal timber stands brought to market logs damaged in a significant wind storm in December 2007.

CUSTOMERS

Annual harvest volume and average price paid as of December 31, is as follows:

	2008		2007		2006	
Destination	**Volume***	**Price/MBF**	Volume*	Price/MBF	Volume*	Price/MBF
Domestic mills	**24,191**	**$531**	43,258	$652	44,315	$659
Export brokers	**5,615**	**610**	3,319	612	3,105	700
Pulp	**7,942**	**359**	8,584	382	7,113	268
Total	**37,748**	**$506**	55,161	$607	54,533	$611

**Volume in MBF*

Domestic mills purchased 64% of our harvest in 2008 versus 78% in 2007. The decline in the proportion of log volume sold to domestic mills resulted from an increase in volume sold to export brokers and pulp mills. Export brokers represent those log buyers that purchase our logs and then resell them primarily to the export market. Export brokers purchased 15% of our 2008 harvest, versus 6% in 2007. Pulp mills purchased 21% of our harvest volume in 2008 as compared to 16% of 2007.

Domestic mills purchased 78% of our harvest in 2007 versus 81% in 2006. The decline in the proportion of log volume sold to domestic mills was offset by an increase in volume sold to pulp mills, where prices were 42% higher in 2007 than 2006. While export brokers purchased roughly the same volume, prices were 13% lower in 2007 than 2006, due to a shift from selling Douglas-fir to whitewood in the export market. Whitewood has a lower average value than Douglas-fir.

HARVEST VOLUMES AND SEASONALITY

The Partnership's 114,000 acres of timberland consist of both the 70,000-acre Hood Canal tree farm and the 44,000-acre Columbia tree farm. The Hood Canal tree farm is located in the Hood Canal region of Washington State. Most of this tree farm acreage is at a relatively low elevation where harvest activities are possible year-round. As a result of this competitive advantage, we are often able to harvest and sell a greater portion of our annual harvest in the first half of the year when the log supply in the marketplace tends to be lower. In 2008, our harvest was for the most part evenly spread between the first three quarters of the year due in part to a lower planned harvest level from the Hood Canal tree farm and an uncertain market for logs that led us to a more even-flow harvest schedule in 2008 versus prior years.

The percentage of annual harvest volume by quarter for each year in the three-year period ended December 31, 2008 is as follows:

Year ended	Q1	Q2	Q3	Q4
2008	**25%**	**38%**	**31%**	**6%**
2007	18%	41%	28%	13%
2006	40%	31%	22%	7%

COST OF SALES

Cost of sales for the Fee Timber segment consists of harvest costs and depletion expense. Harvest costs represent the direct cost incurred to convert trees into logs and deliver those logs to their point of sale and associated state excise taxes owed on the harvest of logs. Depletion expense represents the cost of acquiring or growing the timber harvested. We are using two separate depletion rates in 2008 and 2007, with our primary pool used for volume harvested from the Hood Canal and Columbia tree farms and the second pool for volume harvested from tree farms owned by Fund I. In 2006, we also harvested from two separate depletion pools consisting of our primary pool and the pool used for timber harvested from the timberland acquired in the fourth quarter of 2004. Depletion expense is calculated by first deriving a depletion rate as follows:

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

The depletion rate is then applied to volume harvested to calculate depletion expense. In 2008, we changed our definition of "merchantable" to 35-year-and-older timber from 40-year-and older in previous years.

Fee Timber cost of sales, expressed on a per MBF basis for each year in the three-year period ended December 31, 2008, is as follows:

Year ended	Harvest, Haul and Other per MBF	Depletion per MBF	Total Cost of Sales per MBF*
2008	**$198**	**$91**	**$289**
2007	200	87	287
2006	187	110	297

** Total excludes cost of conservation easement sale*

As described above, the depletion rate is calculated by dividing the historical cost of the timber and related capitalized road expenditures by merchantable timber volume. That calculated rate is then applied to volume harvested. We harvested a total of 37,748 MBF in 2008, with 5,293 MBF attributable to the separate depletion pool created for the Fund I timberlands. The separate depletion pool for Fund I harvest is higher than the pooled rate used for the Partnership's harvest due to historical cost basis attributed to this timber. The majority of the pooled lands have been owned for decades and carry relatively low historical cost in comparison to the Fund I properties we purchased in late 2006. The depletion rate used in the Fund I separate pool under normal market conditions would approximate the net stumpage value realized (delivered log price less harvesting and transportation cost) on the sale of this particular timber. However in today's weak market conditions the net stumpage realized is less than the depletion rate resulting in a loss on timber harvested from Fund I.

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 resulting from timber harvest for each year in the three-year period ended December 31, 2008 was made up of the following:

	Year ended December 31, 2008		
	Pooled	**Fund I**	**Total**
Volume harvested (MBF)	**32,455**	**5,293**	**37,748**
Rate/MBF	**$64.52**	**$253.73**	**$91.05**
Depletion expense ($000's)	**$2,094**	**$1,343**	**$3,437**

	Year ended December 31, 2007		
	Pooled	Fund I	Total
Volume harvested (MBF)	49,824	5,337	55,161
Rate/MBF	$70.31	$237.77	$86.51
Depletion expense ($000's)	$3,503	$1,269	$4,772

	Year ended December 31, 2006		
	Pooled	Quilcene	Total
Volume harvested (MBF)	47,682	6,851	54,533
Rate/MBF	$68.97	$396.63	$110.13
Depletion expense ($000's)	$3,288	$2,717	$6,006

Harvest costs vary based upon the physical site characteristics of acreage harvested. Harvest units that are difficult to access, or that are located on steep hillsides requiring cable harvest systems, are more expensive to harvest. Haul costs vary based upon the distance between the harvest site and the customer's location. Per MBF harvest and haul costs were slightly lower in 2008 relative to 2007 due to the selection of less expensive harvest units in the face of weak log pricing. The increase in harvest and haul costs in 2007 relative to 2006 is due to the location of the harvest units, where logs harvested in 2007 compared to 2006 were hauled a greater distance to customer locations.

Fee Timber cost of sales for each year in the three-year period ended December 31, 2008 is as follows (all dollar amounts in millions):

Year ended *(in millions)*	**Harvest, Haul and Other**	**Cost of Conservation Easement Sale**	**Depletion**	**Total Cost of Sales**
2008	**$7.5**	**$2.2**	**$3.4**	**$13.1**
2007	11.0	–	4.8	15.8
2006	10.2	–	6.0	16.2

Fee Timber cost of sales decreased $2.7 million in 2008 from 2007 and decreased $384,000 in 2007 from 2006. The decrease in 2008 from 2007 is due to a decline in volume harvested partially offset by land basis expensed with the sale of a conservation easement by Fund I. The decrease in 2007 versus 2006 is due to a decline in the average depletion rate used on timber harvested offset by increased harvest costs.

OPERATING EXPENSES

Year ended *(in millions)*	**2008**	2007	2006
Operating expenses	**$4.2**	$4.5	$4.4
Average acres	**137,780**	137,321	120,119
$/Acre	**$30**	$33	$37

Fee Timber operating expenses for each of the three years ended December 31, 2008, 2007, and 2006 were $4.2 million, $4.5 million, and $4.4 million, respectively. Operating expenses include management, silviculture and the cost of both maintaining existing roads and building temporary roads required for harvest activities. Operating costs remained relatively consistent in all three years despite the addition of 24,000 acres owned by Fund I. This is due primarily to the benefits of scale we enjoy as a result of adding acreage to this segment.

Timberland Management & Consulting

REVENUE AND OPERATING INCOME

The Timberland Management & Consulting segment generates revenue by providing timberland management and forestry consulting services to timberland owners and managers. An additional aspect of this segment's activities is the development of timberland property investment portfolios on behalf of third-party clients and the Funds.

The Timberland Management & Consulting segment is currently managing approximately 267,000 acres of timberland for Cascade Timberlands LLC and an additional 24,000 acres for Fund I. The Cascade project includes management, consulting, and disposition services. Revenue and operating income for the Timberland Management & Consulting segment for each year in the three-year period ended December 31, 2008, are as follows (all dollar amounts in millions):

Year ended	Revenue	Operating income (loss)
2008	**$0.9**	**$(0.5)**
2007	1.3	(0.9)
2006	3.7	1.3

Fiscal Year 2008 compared to 2007. Revenue and operating loss for 2008 were $400,000 and $340,000 lower, respectively, than in 2007. The decrease in revenue and operating loss is due primarily to the closure of our timberland consulting office in McCloud, California in December 2007. Revenue also declined due to a decline in acres under management for Cascade Timberlands.

We completed our first closing of Fund II in 2008 with $46.3 million of committed capital, including our 20% co-investment. We expect to complete the second and final closing of Fund II at the end of first quarter of 2009 with $100 million of equity capital, including our 20% co-investment. At each closing, all investors are required to contribute 1% of their equity capital commitment. The remaining equity capital commitment will be contributed as suitable timber properties are identified and acquired.

Fiscal Year 2007 compared to 2006. Revenue and operating income for 2007 were $2.4 million and $2.2 million lower, respectively, than in 2006. The decrease in 2007 is due to a decline in acres under management due to additional sales of Cascade's timberlands and $1.3 million in non-recurring timberland disposition fees earned in 2006.

Fund I and Fund II were formed by Olympic Resource Management LLC to attract investor capital to purchase timberlands. Fund I had a $61.8 million capital commitment, of which $58.5 million was placed in late 2006. Pope Resources' co-investment totaled $11.7 million, or 20% of Fund I. Fund II is planned as a $100 million fund, of which we have a 20% co-investment commitment. Both Funds are treated as consolidated subsidiaries whose results are reported under the Fee Timber segment. Operating results attributed to the 80% third-party interest in the Funds are reported under Minority Interest below operating income.

OPERATING EXPENSES

Fiscal Year 2008 compared to 2007. Timberland Management & Consulting operating expenses decreased $740,000 in 2008 from 2007. This is attributed to a decrease in organization costs associated with Fund II as well as the closure of the McCloud, California office in December 2007.

Fiscal Year 2007 compared to 2006. Timberland Management & Consulting operating expenses decreased $177,000 in 2007 from 2006. This is attributable to decreased activities associated with Cascade timberlands netted against an increase in organization costs associated with Fund II.

Real Estate

REVENUE AND OPERATING INCOME

The Partnership's Real Estate segment consists primarily of revenue from the sale of land together with residential and commercial property rents. The Partnership's real estate holdings are located primarily in Pierce, Kitsap, and Jefferson Counties in Washington State.

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, 2008, are as follows (all dollar amounts in millions):

Year Ended	Revenue	Environmental remediation expense	Operating income (loss)
2008	**$3.7**	**$ –**	**$(1.1)**
2007	15.0	1.9	5.2
2006	27.3	0.3	13.9

Revenue in the Real Estate segment is generated through the sale of land and the rental of homes and commercial properties at the Port Gamble townsite. Land sales include the sale of raw 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 Lifestyles 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.

Real Estate segment revenue for each year in the three-year period ended December 31, 2008 consists of the following (all dollar amounts in thousands):

Description	Revenue	Gross Margin	Acres Sold	Revenue/ Acre	Gross Margin/ Acre
Rural Residential	**$1,626**	**$1,058**	**216**	**$8**	**$4.9**
Rentals	**1,158**	**1,157**	**NA**	**NA**	**NA**
Conservation Easement	**830**	**418**	**NA**	**NA**	**NA**
Other	**69**	**71**	**NA**	**NA**	**NA**
2008 Total	**$3,683**	**$2,704**	**216**	**$8**	**$4.9**
Commercial/Business Park	$11,124	$7,155	15	$719	$463
Revenue Recognized on % Complete for 2006 Closings	1,346	838	NA	NA	NA
Other Land Sale	1,018	964	91	$11	$11
Rural Residential	553	458	50	$11	$9
Rentals	982	982	NA	NA	NA
Other	14	15	NA	NA	NA
2007 Total	$15,037	$10,412	156	$81	$55
Commercial/Business Park	$11,637	$6,184	37	$315	$167
Residential Plat	10,673	7,715	200	$53	$39
Rural Residential	2,596	1,872	527	$5	$4
Other Land Sale	1,400	1,003	401	$3	$3
Rentals	1,002	1,002	NA	NA	NA
Other	12	12	NA	NA	NA
2006 Total	$27,320	$17,788	1,165	$23	$14

Fiscal Year 2008 compared to 2007. In 2008, revenue for the Real Estate segment decreased by $11.3 million and operating income decreased $6.3 million from 2007 results. The large decrease in revenue and operating results is attributed to a decline in sales of land stemming both from the weak market for land experienced in 2008, the relatively large commercial sales experienced in 2007 which were the direct result of multi-year investments made during and prior to 2007, and $1.3 million of non-recurring revenue recognized in 2007 related to sales closed in 2006.

Nearly all of the land transactions in 2008 were sold from the Rural Residential lot program. The Partnership's Rural Residential lot program typically produces lots from 5 to 80 acres in size, based on underlying zoning densities. This type of program entails an entitlement effort typically consisting of simple lot segregations and boundary line adjustments. Development activities include minor road building, surveying, and the extension of utilities. Rural Residential revenue in 2008 consisted of 7 separate transactions totaling 216 acres. Demand for rural lots has dropped significantly in 2008 commensurate with decreased housing demand. The $830,000 of conservation easement revenue is reported in the Real Estate segment as it was generated from the sale of a conservation easement on 126 acres of development property. The conservation easement restricts us from harvesting 2,000 MBF of timber and does not allow building on the property but does create value on neighboring parcels of property that we own through the protected open space created by the conservation easement.

Management intends to offer a steady supply of rural residential lots to the market that will result in an ongoing revenue stream for the Real Estate segment. We have a target of selling 150 to 300 acres annually. We expect 2009 rural residential sales to end up at the low end of this targeted range due to softness in our local markets for rural residential land.

Fiscal Year 2007 compared to 2006. In 2007, revenue and operating income for the Real Estate segment decreased by $12.3 million and $8.7 million, respectively, over 2006 amounts. The large revenue decrease can be attributed primarily to the large transactions occurring in 2006 and to a lesser extent on softening real estate market conditions in 2007.

Commercial/business park transactions in 2007 included sales from our Gig Harbor and Bremerton projects and a single acre of property located in Poulsbo, Washington. In Gig Harbor we sold a total of 12 acres resulting in $9.9 million of revenue and $6.6 million of gross margin. These Gig Harbor transactions included a 6-acre sale for $7.2 million that was closed in 2006, but due to a right of rescission the revenue was not recognized until 2007 when this right of rescission terminated after we completed required infrastructure improvements. At our Bremerton project we sold two industrial lots representing over two acres resulting in $1.0 million of revenue and $0.4 million of gross margin. The remaining commercial/business park property sale was a 1-acre parcel near our headquarters in Poulsbo that was sold for $230,000 resulting in gross margin of $166,000.

Revenue recognized using the percentage completion method primarily related to the 2006 sale of a 200-acre, residential plat from our Bremerton project. Certain obligations under the purchase and sale agreement were not completed as of December 31, 2006 and, as a result, 2007 results include $1.3 million in revenue and $838,000 of gross margin from this sale.

The 91-acre, $1.0 million "Other Land Sale" in the preceding table represents a sale to Kitsap County Parks. This land will be used as part of a public trail system that we expect to add value to the community and our development properties in North Kitsap County.

Rural Residential revenue in 2007 consisted of 3 separate transactions totaling 50 acres and represented a 91% decrease in acres sold compared to 2006. Demand for rural lots dropped significantly in 2007 commensurate with decreased demand for housing.

COST OF SALES

Real Estate cost of sales for each of the three years ended December 31, 2008, 2007, and 2006 were $979,000, $4.6 million, and $9.5 million, respectively. Cost of sales during the periods presented result from the aforementioned land sales. The decreases in cost of sales in 2008 relative to 2007, and in 2007 compared to 2006, were due primarily to a decline in acres sold.

OPERATING EXPENSES

Real Estate operating expenses for each of the three years ended December 31, 2008, 2007, and 2006 were $3.8 million, $3.4 million, and $3.7 million, respectively. Operating expenses increased $444,000 in 2008 compared to 2007 due primarily to an increase in professional costs incurred in the pursuit of entitlements for real estate projects. Operating expenses decreased $293,000 in 2007 compared to 2006 due to a reduction in project-related expenditures incurred in connection with a number of ongoing long-term projects, particularly at Gig Harbor, Bremerton, Kingston, and Port Gamble.

ENVIRONMENTAL REMEDIATION

The Partnership has accrued liabilities for environmental cleanup of $1.6 million and $2.0 million as of December 31, 2008 and 2007, respectively, for estimated environmental remediation charges in and around the townsite of Port Gamble. Port Gamble is a historic town that was owned by P&T for decades until 1985 when the townsite and other assets were spun off to the Partnership. P&T continued to operate the townsite through 1995 and leased the millsite at Port Gamble until January 2002 when a settlement agreement was signed between the Partnership and P&T. This settlement agreement set forth how the two companies were to apportion the costs and responsibility for environmental remediation in Port Gamble. The "millsite" is referred to as such because a lumber mill operated on that portion of the property for more than one hundred years until 1995, before it was dismantled by the end of 1996.

Our 2007 results reflect a $1.9 million charge to earnings to increase our environmental remediation liability. This amount reflects our estimate of potential liability associated with environmental contamination at Port Gamble. This contamination is believed to have occurred during the years P&T operated a mill at Port Gamble, from 1853 to 1995. At the time Pope Resources was spun off from P&T, Port Gamble was included in our assets, and after contamination was discovered at the townsite, millsite, and in the adjacent bay, we entered into a settlement and remediation agreement with P&T pursuant to which we and P&T allocated responsibility for cleanup costs. Under Washington law, both Pope Resources and P&T are "potentially liable persons" based on ownership and/or operation of the site.

P&T's declining financial condition culminated in a late October 2007 bankruptcy filing in Canada, followed in November 2007 by a Chapter 11 bankruptcy filing in the United States. Since the initial bankruptcy filing, P&T has undertaken to sell substantially all of its assets, converting its original petition to a Chapter 7 liquidation plan in May 2008 and as of August 2008, is in the final stages of Chapter 15 liquidation. These events cause us to believe that P&T will be unable to meet the remaining portion of its obligations under our settlement and remediation agreement.

Because of the joint and several liability that attends to the cleanup obligation, management has taken a number of steps to address our own exposure as follows:

- We are working closely with environmental consultants to actively manage the process and status of the remediation efforts.
- As noted above, our environmental remediation liability is estimated to be $1.6 million at the end of 2008 to reflect our current estimate of the remediation costs.
- We are in active discussions with the Washington State Department of Ecology to promote protection of the environment, optimize and appropriately allocate the remaining cleanup liabilities, and maximize our control over the remediation process.

Management continues to monitor closely both the Port Gamble cleanup process and the P&T bankruptcy proceeding. The $1.6 million liability balance as of December 31, 2008 represents management's best estimate of the liability for work remaining at the site based upon an estimation method that represents the most likely outcome. The range of potential liabilities is $816,000 to $4.5 million which represents the range of two standard deviations from the mean of possible outcomes generated by the statistical modeling process used to estimate this liability as of December 31, 2008.

The environmental liability at December 31, 2008 includes $300,000 that the Partnership expects to expend in the next 12 months and $1.3 million thereafter. Activities at the site during 2008 included dismantling a sparge area of dredged materials on the millsite itself and costs for developing a clean-up plan for the site as a whole. 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**	**Balances at the End of the Year**
2006	158	260	176	242
2007	242	1,878	126	1,994
2008	**1,994**	–	**440**	**1,554**

General & Administrative (G&A)

Fiscal Year 2008 compared to 2007. G&A costs decreased $831,000, or 17%, to $4.0 million from $4.8 million in 2007. The decrease in G&A expense is due primarily to professional service fees incurred in 2007 to evaluate capital structuring alternatives with management and the Board of Directors of the General Partner that did not recur in 2008. G&A costs represented 14% of revenue in 2008.

Fiscal Year 2007 compared to 2006. G&A costs increased $965,000, or 25%, to $4.8 million from $3.8 million in 2006. The increase in general and administrative expense is due primarily to aforementioned professional service fees incurred in 2007. G&A costs represented 9% of revenue in 2007.

Interest Income and Expense

Interest income for 2008 decreased to $965,000 from $1.8 million in 2007 and $1.2 million in 2006. The decrease in interest income in 2008 is due primarily to a decrease in cash investments combined with a decrease in average interest earned. The increase in interest income in 2007 versus 2006 is due to higher average cash and short-term investment balances. During 2008, we have invested cash in excess of immediate operating cash requirements in treasury securities and money market accounts. We also have $4 million par value of student loan auction rate securities with the highest credit rating of Aaa/AAA. The maturities on these securities are long-term while the interest rate resets every 28 days. Further student loan auction rate securities information is presented in "Liquidity and Capital Resources" below and in Note 2 to our consolidated financial statements included in this report.

Interest expense, net of interest capitalized to development projects, was $1.2 million for 2008, $1.4 million for 2007, and $1.8 million for 2006. The decrease in interest expense from 2006 to 2007 and 2007 to 2008 is attributable to regularly scheduled principal payments due on our timberland mortgage and an increase in capitalized interest related to increased basis on land projects under development. The Partnership's debt consists primarily of mortgage debt with a fixed interest rate and amortization schedule. The outstanding debt has not been reduced with available cash and short-term investment balances because the terms of the timberland mortgages include a "make whole" premium payable to the lender for unscheduled principal payments.

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 2008 compared to 2007. We have recorded an income tax benefit of $61,000 in 2008, whereas we had recorded a benefit of $69,000 in 2007. The tax benefits recorded in 2008 and 2007 result from losses incurred in ORMLLC as we work on building the private equity timber fund business while management fees generated from the Cascade Timberlands management contract decline.

Fiscal Year 2007 compared to 2006. We have recorded an income tax benefit of $69,000 in 2007, whereas we had recorded a provision for income taxes of $439,000 in 2006. The tax benefit in 2007 results from the operating loss generated by our Timberland Management & Consulting segment. In 2007 the Timberland Management & Consulting segment generated income from management and disposition services provided to Cascade Timberlands that declined in subsequent years as properties were sold.

Minority Interest

Minority Interest represents the 80% portion of 2008 net loss of the Funds attributed to third-party owners of the Funds. The increase in this amount from prior year is due to the increase in operating activities of Fund I given its acquisition of timberland in late 2006.

Minority Interest-IPMB

Minority Interest-IPMB represents that share of income earned from the Investor Portfolio Management Business (IPMB) allocated to Pope MGP, Inc., the Managing General Partner of the Partnership. The 1997 amendment to the Limited Partnership Agreement authorizing the Partnership to pursue the IPMB further specifies that income from the IPMB will be split using a sliding scale allocation method beginning at 80% to the Partnership's wholly-owned subsidiary, ORM, Inc., and 20% to Pope MGP, Inc. The sliding scale allocation method evenly divides IPMB income between ORM, Inc. and Pope MGP, Inc. once such income reaches $7,000,000 in a given fiscal year. The share of IPMB allocated to Pope MGP is further split between Pope MGP and a management incentive plan. In 2008 and 2007, Pope MGP's share of the IPMB was $0.

Current activities of the IPMB are contained in the Timberland Management & Consulting segment, which include timberland consulting, management and disposition services, and expenses associated with the launch of Fund II.

Fiscal Year 2008 compared to 2007. The charge or expense that is the allocation of income to a minority interest is zero for both 2008 and 2007 due to current losses in the Timberland Management & Consulting segment as we work on growing our private equity timber fund business.

Fiscal Year 2007 compared to 2006. The charge or expense that is the allocation of income to a minority interest decreased to zero in 2007 from $77,000 in 2006. The decrease in minority interest allocation is due to the reduction in the per-acre management fee rate for our primary timberland management client and expenses associated with launching Fund II.

LIQUIDITY AND CAPITAL RESOURCES

Cash Flows

We ordinarily finance our business activities using funds from operations and, where appropriate in management's assessment, bank lines of credit. We generate operating cash flow through the sale of timber products; by providing timberland management, disposition, and consulting services; by developing timberland investment portfolios for third-parties; and by selling land for development. Significant recurring uses of cash include the following: replanting and fertilizing trees; maintaining an adequate road system on our tree farms; investing in our development properties; funding annual debt payments on timber mortgages and local improvement district debt; funding quarterly cash distributions and unit repurchase programs; and funding general and administrative expenses.

Funds generated internally from operations and externally through financing are expected to provide the required resources for the Partnership's future capital expenditures. Cash and cash equivalents are currently being invested directly in treasury bills and in money market funds that invest only in U.S. government-issued securities. The Partnership's debt-to-total-capitalization ratio as measured by the book value of equity was 25% at December 31, 2008 versus 24% at December 31, 2007. The change in debt-to-total-capitalization ratio at December 31, 2008 reflects offsetting year-to-date events. The first was our annual timberland mortgage payment of $1.3 million which occurred on March 31 that reduced long-term debt outstanding, offset by $7.4 million in distributions to unitholders and $3.9 million in units repurchased pursuant to our unit repurchase program that began in late 2007.

At December 31, 2008, the Partnership held AAA-rated Student Loan Auction Rate Securities (SLARS) with a par value of $4.0 million but an estimated fair value of $3.6 million. SLARS are collateralized long-term debt instruments that are intended to provide liquidity through a Dutch auction process that resets the applicable interest rate at pre-determined intervals, typically every 28 days. Beginning in February 2008, auctions failed for approximately $17 million in par value of SLARS we held because sell orders exceeded buy orders. Although higher interest rates for SLARS went into effect upon failure of the auctions, the principal amount of the securities associated with failed auctions will not be accessible until the issuer calls the security, a successful auction occurs, a buyer is found outside of the auction process, or the security matures. We have thus classified the remaining $4.0 million par value of SLARS — where we have received neither a repurchase agreement from the broker-dealer nor an agreement to redeem by the issuer — as a non-current asset at management's estimate of fair value of $3.6 million.

Moody's Investors Service downgraded two of the four securities in our SLARS portfolio from Aaa to A3 in February 2009. Standard and Poor's AAA rating was not changed. These two securities represent half of the par value of our remaining SLARS portfolio. The new lower rating, which occurred in February 2009, is expected to have a negative impact on the value of these securities in 2009. We have filed a claim with the Financial Industry Regulatory Authority (FINRA) against the broker that sold us the $4.0 million par value of SLARS. The FINRA claim is currently in arbitration with a hearing scheduled for June 2009 and the results will not be known until the arbitration process is complete.

The Partnership's debt consists primarily of a timberland mortgage with a fixed amortization schedule and loan term, which includes a prepayment penalty. One of the consequences of our planned reduction in harvest is that we anticipated falling below the minimum threshold for our cash flow covenant. We alerted our mortgage lender to this and in October 2008, we received from the mortgage lender a waiver of the cash flow coverage ratio's applicability beginning with the fourth quarter of 2008, through and including the fourth quarter of 2010. On July 31, 2008, the Partnership entered into a $40 million revolving line of credit with Northwest Farm Credit Services. Northwest Farm Credit Services provides financing and related services to timber producers, farmers, ranchers, commercial fishermen, and agribusinesses in the Pacific Northwest. It is part of the 90-year-old Farm Credit System, a nationwide network of customer-owned lending institutions and specialized service organizations that provide about one-third of the total credit used by America's farmers, ranchers and agricultural cooperatives. Our unsecured revolving loan agreement with Northwest Farm Credit Services matures in August 2011 and requires that we maintain a minimum debt-to-total capitalization ratio that the Partnership currently satisfies. As of December 31, 2008, there were no amounts outstanding on the line of credit. Management believes that the cash we hold in excess of our current operating needs together with this newly obtained line of credit provides ample liquidity for our near-term operating needs.

We have completed our first closing of Fund II with a committed capital balance of $46.3 million. Management anticipates that following the final closing in the first quarter of 2009 Fund II will be sized at approximately $100 million and that we will co-invest at the same 20% level ($20 million in this case), as was done for Fund I. At each closing 1% of the committed equity capital is collected from each investor. The remaining capital calls will be made on this commitment as properties are acquired.

The annual harvest target for 2009 is expected to be approximately 37 MMBF which is consistent with 2008 harvest. This represents a 30% reduction from our currently estimated sustainable harvest volume of 52 MMBF. The decision to defer harvest was made in response to our expectation of continued weakness in the market for sawlogs resulting from the slowdown in housing starts. We plan to harvest 5 MMBF from the tree farms owned by Fund I in 2009. This represents a 42% reduction from Fund I's sustainable harvest level of 8 MMBF.

During the year ended December 31, 2008, overall cash and cash equivalents increased $15.8 million resulting from the sale of short-term investments. During the year ended December 31, 2007, overall cash and cash equivalents decreased by $5.0 million while we invested an additional $5.8 million in short-term investments.

Operating cash activities. The table below provides the components of operating cash flows for each annual period ended December 31. Cash received from customers and paid to suppliers and employees results from the harvest and sale of forest products from our tree farms; timberland management, disposition, and consulting services provided to timberland owners; and finally, the sale of development properties.

Operating cash activities *(in thousands)*	**2008**	2007	2006
Cash received from customers	**$29,071**	$47,667	$69,548
Cash paid to suppliers and employees	**(21,281)**	(24,473)	(25,030)
Interest received	**1,025**	1,712	1,095
Interest paid	**(1,401)**	(2,585)	(1,795)
Income taxes paid	**(11)**	(340)	(247)
Total	**$7,403**	$21,981	$43,571

Cash generated by operating activities decreased to $7.4 million in 2008 from $22.0 million in 2007. The decrease in cash generated by operating activities resulted primarily from the decrease in timber harvest and reduced land sales in response to weak markets for logs and land.

Cash generated by operating activities decreased to $22.0 million in 2007 from $43.6 million in 2006. The decrease in cash generated by operating activities resulted primarily from two major non-recurring land sales in 2006 that resulted in nearly $20.0 million of cash flow.

Investing cash activities. The table below represents the annual components of cash used by year in investing activities for each annual period ended December 31. Recurring investing activities consist primarily of tree planting, road building and investment in our development properties to build infrastructure and acquire the entitlements necessary to make further development of the properties possible.

Investing activities *(in thousands)*	**2008**	2007	2006
Buildings and equipment	**($555)**	($793)	($622)
Development properties	**(3,451)**	(9,868)	(10,458)
Timber and roads	**(1,160)**	(1,501)	(1,098)
Timberland acquisitions	**(904)**	–	(57,805)
Redemption (purchase) of short-term investments	**26,775**	(5,775)	(10,000)
Proceeds from the sale of fixed assets	**41**	64	–
Cash provided by (used in) investing activities	**$20,746**	($17,873)	($79,983)

Cash provided by investing activities increased to $20.7 million in 2008 from cash used in investing activities of $17.9 million in 2007. The increase in 2008 from 2007 is due primarily to the redemption of SLARS, coupled with a reduction in cash invested in development properties. In 2008, we liquidated $26.8 million in SLARS versus 2007 when we purchased $5.8 million in SLARS. During 2008, we invested $3.5 million in development properties, $1.2 million in timber and roads and approximately $555,000 in other capital expenditures. In addition to $904,000 spent in a land acquisition, we incurred capital expenditures for development costs in 2008 for the following Real Estate properties: $777,000 at Gig Harbor, $521,000 at Bremerton, $1.3 million of capitalized interest related to the Gig Harbor and Bremerton projects, $300,000 at Port Ludlow, $312,000 at Kingston and $290,000 related to other miscellaneous projects.

Cash used in investing activities decreased to $17.9 million in 2007 from $80.0 million in 2006. The decrease in 2007 from 2006 is due primarily to Fund I's 2006 $57.8 million acquisition of two timber properties. In 2007, we invested $5.8 million in short term investments and $793,000 of other capital expenditures. Cash used to purchase short-term investments represents the acquisition of SLARS that were being used as a vehicle for investing cash balances in excess of cash required for immediate operating needs. We incurred capital expenditures for development costs in 2007 for the following Real Estate properties: $2.9 million at Gig Harbor, $2.6 million at Bremerton, $1.6 million for a land acquisition that is contiguous to the Port Gamble townsite, $1.1 million of capitalized interest related to the Gig Harbor and Bremerton projects, $828,000 at Hansville, $610,000 at Kingston and $23,000 related to other miscellaneous projects.

Cash provided by (used in) financing activities. The table below represents the components of cash used in financing activities for each year of the three-year period ended December 31, 2008. Our financing activities primarily reflect payments made on timber mortgages and other debt, unitholder distributions, capital contributions by third-party investors in the Funds, and payments to the Managing General Partner, Pope MGP, for its minority interest allocation of IPMB income. These payments and outflows are partially offset by cash received from the exercise of unit options issued to employees and directors.

Financing activities *(in thousands)*	**2008**	2007	2006
Mortgage/LID payments	**($1,342)**	($1,481)	($1,675)
Cash distribution to unitholders	**(8,244)**	(6,929)	(4,961)
Unit repurchase	**(3,940)**	(1,374)	–
Cash received from unit option exercises	**644**	730	254
Excess tax benefit from equity-based compensation	**167**	–	–
ORM Timber Fund I, LP capital contributions	**–**	–	46,831
ORM Timber Fund II, Inc. capital call	**370**	–	–
Minority interest distribution	**–**	(74)	(204)
Cash provided (used) by financing activities	**($12,345)**	($9,128)	$40,245

Cash used by financing activities was $12.3 million in 2008 as compared to $9.1 million used by financing activities in 2007. This change is due primarily to the use of $3.9 million to acquire Partnership units under two separate unit repurchase plans. The first was announced in November 2007 and was completed in April 2008 with the purchase of $5.0 million in Partnership units. The second plan was announced in December 2008 for the purchase of $2.5 million and was still active as of December 2008. Cash distributions were $1.3 million higher in 2008 than 2007 due to the increase in quarterly distribution rate from $0.28 per unit for the first half of 2007 to $0.40 per unit for the remainder of 2007 and all of 2008.

Cash used by financing activities was $9.1 million in 2007 as compared to $40.2 million provided by financing activities in 2006. This change is due primarily to $46.8 million of capital contributions received by third-party investors to the ORM Timber Fund I. Cash of $1.4 million was used to acquire Partnership units pursuant to a unit repurchase plan authorizing the acquisition of up to $5.0 million of Partnership units commencing November 1, 2007 and completed in April 2008. Cash distributions were $2.0 million higher in 2007 than 2006 due to an increase in our per unit quarterly distributions from $0.28 to $0.40 per unit in the third quarter of 2007.

Expected future changes to cash flows

Operating activities. As discussed above, we plan to maintain our harvest level in 2009 at 37 MMBF in 2009 representing a 30% reduction from our estimated sustainable harvest. This reduction is in response to expected soft prices for logs as the slowdown in housing starts has curtailed demand for solid wood products. Cash generated by Real Estate transactions is expected to decline in 2009 from 2008 due to continued weakness in the market for land.

Investing activities. Management is now working on completing the final close of Fund II. The level of co-investment in Fund II is the same 20% as was the case in Fund I, but the size of Fund II is expected to approximate $100 million. In addition to these co-investment obligations, capital infrastructure expenditures for our Gig Harbor and Port Ludlow projects are expected to total $1.7 million and $165,000, respectively, in 2009. The majority of Gig Harbor capital expenditures in 2009 is expected to reflect work on the residential plat entitlement, utility connections, capitalized interest and infrastructure on the property. Capital expenditures on the Port Ludlow property in 2009 will primarily relate to entitlement efforts and planning for future construction.

Financing activities. Management is currently projecting that cash on hand, short-term investments, 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. In July 2008, we secured a 3-year commitment for a $40 million line of credit from Northwest Farm Credit Services.

Our debt-to-total-capitalization ratio as of December 31, 2008, as measured by the book and market value of our equity, was 25% and 24%, respectively. Should a financing need arise, management is comfortable that there is room to take on some debt with the ratios at these levels, since our loan covenant which limits debt-to-total-capitalization to 50% is measured against the higher of these two calculations. The Hood Canal tree farm secures the Partnership's current timberland mortgages while the Columbia tree farm is not currently used as collateral for any debt obligations. 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 Washington State. Our timber acreage is concentrated in two non-contiguous tree farms: the 70,000-acre Hood Canal tree farm located in Kitsap, Jefferson, and Mason Counties on the eastern side of Washington's Olympic Peninsula, and the 44,000-acre Columbia tree farm located in Cowlitz, Clark, Lewis, and Skamania counties on the western side of Washington's Cascade mountain range.

The Hood Canal tree farm is concentrated at low elevations, which permits us to harvest trees year-round. Generally, we concentrate our harvests from this tree farm in the winter and spring when supply, and thus competition, is typically lower and, accordingly, when we can expect to receive higher prices. With the acquisition of the Columbia tree farm in 2001, and the timberlands acquired by Fund I in 2006, management expected a decrease in the seasonality of Fee Timber operations as the Columbia tree farm and timberlands owned by Fund I are at higher elevations where harvest activities are generally possible only in the late spring and summer months. In practice, over the last two years our harvest has tended to be more front-loaded, as log prices have been relatively strong in the first half of the year and winter weather has been relatively benign, enabling management to front-load the harvest plan. In future periods, management expects quarterly harvest volume to be affected by both local market conditions for logs and weather conditions. The weak log markets we are currently experiencing will lead to a reduced harvest volume in the first quarter of 2009.

Timberland Management & Consulting. Timberland Management & Consulting operations are not 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, with the 2006 year a classic case-in-point. 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, 2008 consist of operating leases, and purchase obligations entered into in the normal course of business.

		Payments Due By Period /Commitment Expiration Date			
Obligation or Commitment *(in thousands)*	**Total**	**Less than 1 year**	**1–3 years**	**4–5 years**	**After 5 years**
Total debt	$29,586	$1,417	$27,947	$219	$3
Operating leases	159	80	63	16	–
Interest on debt	5,312	2,341	2,965	6	–
Environmental remediation	1,554	300	1,254	–	–
Other long-term obligations	236	75	50	50	61
Total contractual obligations or commitments	$36,847	$4,213	$32,279	$291	$64

Environmental remediation represents our estimate of potential liability associated with environmental contamination at Port Gamble. Other long-term obligations consist of a $186,000 liability for a supplemental employment retirement plan and a $50,000 contribution commitment to the YMCA of Pierce County's fund for building a new facility at Gig Harbor. This commitment was made as part of the sale of business park property at the Gig Harbor project to the YMCA.

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

Off-Balance Sheet Arrangements

The Partnership is not a party to off-balance sheet arrangements and does not hold any variable interests in unconsolidated entities.

Capital Expenditures and Commitments

Projected capital expenditures in 2009 are $4.1 million, excluding any potential co-investment by the Partnership in Fund II. Projected capital expenditures are currently expected to include $1.7 million for the Gig Harbor site and $165,000 for the Port Ludlow 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 reclamation costs, ESA 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

In December 2007, the FASB issued SFAS No. 141R, *Business Combinations*, and SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*. These standards were issued jointly and will require most identifiable assets, liabilities, noncontrolling interests, and goodwill acquired in a business combination to be recorded at full fair value and will require noncontrolling interests (previously referred to as minority interests) to be reported as a component of equity, which changes the accounting for transactions with noncontrolling interest holders. Both statements are effective for fiscal years beginning on or after December 15, 2008. SFAS No. 141R will be applied only to acquisitions subsequent to the effective date. SFAS No. 160 will be applied prospectively to all noncontrolling interests, including any that arose before the effective date, except that the presentation and disclosure requirements will be applied retrospectively.

Although management is currently in the process of evaluating the impact of these standards on the Partnership's consolidated financial statements, management expects the impact to include reclassification of the minority interests to equity.

Critical Accounting Policies and Estimates

Management believes its most critical accounting policies and estimates relate to calculations of timber depletion and liabilities for matters such as environmental remediation, and potential asset impairments. In relation to liabilities, potential impairments and other estimated charges, it is management's policy to conduct ongoing reviews of significant accounting policies and assumptions used in the preparation of the financial results of the Partnership. The assumptions used are tested against available and relevant information and reviewed with subject-matter experts for consistency and reliability. During the preparation of financial results, tests are conducted to ascertain that the net book carrying values of assets are not in excess of estimated future cash flows. These tests use current market information, if available, or other generally accepted valuation methods, such as future cash flows. When the use of estimates is necessary, an exact answer is unlikely, and therefore, the range of likely outcomes is used in the preparation of the financial statements. Tests are also applied in order to be reasonably assured that liabilities are properly reflected on the records of the Partnership and that the notes to the financial statements are prepared in a fashion that informs readers of possible outcomes and risks associated with the conduct of business.

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 conservation easement sales and development opportunities.

Depletion. Depletion represents the cost of timber harvested and the cost of the permanent road system and 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 2008, merchantable timber is defined as timber that is equal to or greater than 35 years of age. Prior to 2008, we defined merchantable timber in our depletion calculation as equal to or older than 40 years of age.

To calculate the depletion rate, the Partnership uses a combined pool when the characteristics of the acquired timber are not significantly different from the Partnership's existing timberlands. The depletion cost on recently acquired timber, such as timber harvested from Fund I timberland, under normal market conditions would approximate the net stumpage realized on the sale, however in current market conditions net stumpage realized is less than the depletion rate resulting in a loss from timber harvest.

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

The standing inventory system is subject to two processes each year to monitor accuracy. The first is the annual cruise process and the second is a comparison of (a) volume actually extracted by harvest to (b) inventory in the standing inventory system at the time of the harvest. A "cruise", which utilizes statistical sampling techniques, represents a physical measurement of timber on a specific set of acres. The cruise process is completed when the physical measurement totals are compared to the volume captured in the standing inventory system. Only productive acres with timber that is at least 20 years old are selected as subject to a cruise. The Partnership cruises 15-20% of its productive acres with 20-year-old or greater timber annually. Specific acres are first selected for cruising with a bias towards those acres that have gone the longest without a cruise and, second, with a bias towards those acres that have been growing the longest. As the cruise is being performed, only those trees with a breast height diameter (approximately 4.5 feet from the ground) of at least 6 inches are measured for inclusion in the inventory.

A hypothetical 5% change in estimated timber inventory volume would have changed 2008 depletion expense by $110,000.

Environmental remediation. The environmental remediation liability represents estimated payments to be made to monitor (and remedy if necessary) certain areas in and around the townsite and millsite of Port Gamble, Washington. Port Gamble is a historic town that was owned and operated by P&T, formerly a related party, until 1985 when the townsite and other assets were spun off to the Partnership. P&T continued to operate the townsite until 1996 and leased the millsite at Port Gamble through January 2002, at which point P&T signed an agreement with the Partnership dividing the responsibility for environmental remediation of Port Gamble between the two parties. Under Washington law, both Pope Resources and P&T are "potentially liable persons" based on ownership and/or operation of the site. These laws provide for joint and several liability among parties owning or operating property on which contamination occurs, meaning that cleanup costs can be assessed against any or all such parties. Our agreement with P&T was intended to apportion responsibility based on this principle, with P&T bearing the larger share of responsibility based upon their role in operating the site and upon their relatively lengthy ownership.

However, P&T's financial condition has declined markedly in recent years, culminating in a late October 2007 bankruptcy filing in Canada, followed in November 2007 by a Chapter 11 bankruptcy filing in the United States. In May 2008, a bankruptcy judge approved a request from P&T to convert the Chapter 11 reorganization to a Chapter 7 liquidation plan. In August 2008, the Chapter 7 was subsequently converted to Chapter 15 to complete the liquidation of the remaining P&T assets in Canada. We are in active discussions with the Washington State Department of Ecology to promote protection of the environment, optimize and appropriately allocate the remaining cleanup liabilities, and maximize our control over the remediation process. We continue to monitor the P&T bankruptcy action.

As of December 31, 2008 the balance in the liability account related to the Port Gamble remediation project is $1.6 million which represents our best estimate of the remaining cost to complete this project. The range of potential liabilities is $816,000 to $4.5 million which represents the range of two standard deviations from the mean of possible outcomes generated by the statistical modeling process used to estimate this liability as of December 31, 2008. These estimates are based upon a number of assumptions and contingencies that may or may not come to pass. As a result the actual cost of this project may vary materially from our current estimates.

Property development costs. The Partnership is developing several master planned communities with the Gig Harbor and Bremerton projects being the most notable currently. Costs of development, including interest, are capitalized for these projects and allocated to individual lots based upon their relative preconstruction value. This allocation of basis supports, in turn, the computation of those amounts reported as a current vs. long-term asset ("Land Held for Sale" and "Land Held for Development", respectively). As lot sales occur, the allocation of these costs becomes part of cost of sales attributed to individual lot sales. Costs associated with land including acquisition, project design, architectural costs, road construction, capitalized interest and utility installation are accounted for as investment activities (as opposed to an operating activity) on our statement of cash flows. These investments are often made for a number of years prior to the realization of revenue from the disposition of these properties. Cash generated from the sale of these properties is classified as an operating activity on our cash flow statement as the sale of these properties is the main operating activity of our Real Estate segment.

Percentage of Completion Revenue Recognition. The partnership accounts for revenue recognized from development sales consistent with Statement of Financial Accounting Standards No. 66, Accounting for 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 Statement of Financial Accounting Standards No. 144 *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS No. 144). SFAS No. 144 requires recognition of an impairment loss in connection with long-lived assets used in a business when the carrying value exceeds the estimated future undiscounted cash flows attributable to those assets over the expected useful life. The Partnership obtains annual appraisals of its timberlands and compares the appraised value of those properties to the carrying value to determine if an asset impairment is indicated. The long-term holding period of timberland properties makes an asset impairment unlikely as the undiscounted expected cash flows from a timberland property would need to decrease very significantly to not total in excess of the carrying value of a timber property. When facts and circumstances indicate the carrying value of properties may be impaired, an evaluation of recoverability is performed by comparing the carrying value of the property to the projected future undiscounted cash flows. Upon indication that the carrying value of such assets may not be recoverable, the Partnership would recognize an impairment loss, determined on the basis of fair market value, and charge this amount against current operations. The land basis associated with most of our development properties is well below current market value; therefore, an asset impairment charge on one of our development projects is not likely.

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

CONSOLIDATED BALANCE SHEETS

Years ended December 31 (in thousands)	**2008**	2007
ASSETS		
Current assets:		
Cash and cash equivalents	**$17,978**	$2,174
Short-term investments	**–**	30,775
Accounts receivable, net	**500**	442
Land held for sale	**596**	780
Current portion of contracts receivable	**477**	622
Prepaid expenses and other	**295**	252
Total current assets	**19,846**	35,045
Properties and equipment, at cost:		
Land held for development	**23,931**	21,159
Land	**20,449**	22,318
Roads and timber, net of accumulated depletion of $52,552 and $48,418	**92,753**	94,635
Buildings and equipment, net of accumulated depreciation of $7,360 and $7,017	**3,565**	3,577
Total properties and equipment, at cost	**140,698**	141,689
Other assets:		
Contracts receivable, net of current portion	**994**	1,420
Student loan auction rate securities	**3,619**	–
Other	**254**	1,171
Total other assets	**4,867**	2,591
Total assets	**$165,411**	$179,325
LIABILITIES AND PARTNERS' CAPITAL		
Current Liabilities:		
Accounts payable	**$635**	$1,371
Accrued liabilities	**863**	2,112
Current portion of environmental remediation	**300**	250
Current portion of long-term debt	**1,417**	1,342
Minority interest - IPMB	**3**	3
Deposits	**158**	105
Deferred revenue	**205**	268
Total current liabilities	**3,581**	5,451
Long-term debt	**28,169**	29,385
Minority interest	**44,354**	45,803
Environmental remediation	**1,254**	1,744
Other long-term liabilities	**236**	298
Commitments and contingencies		
Partners' capital (units outstanding: 4,599 and 4,663)	**87,817**	96,644
Total liabilities and partners' capital	**$165,411**	$179,325

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS

Years ended December 31 (in thousands, except per unit information)	**2008**	2007	2006
Revenue:			
Fee Timber	**$23,551**	$35,514	$35,260
Timberland Management & Consulting	**944**	1,344	3,670
Real Estate	**3,683**	15,037	27,320
Total revenues	**28,178**	51,895	66,250
Costs and expenses:			
Cost of sales:			
Fee Timber	**(13,092)**	(15,837)	(16,221)
Real Estate	**(979)**	(4,625)	(9,532)
Total cost of sales	**(14,071)**	(20,462)	(25,753)
Operating expenses:			
Fee Timber	**(4,165)**	(4,462)	(4,447)
Timberland Management & Consulting	**(1,487)**	(2,227)	(2,404)
Real Estate	**(3,815)**	(3,371)	(3,664)
Real Estate environmental remediation	**–**	(1,878)	(260)
General & Administrative (G&A)	**(3,951)**	(4,782)	(3,817)
Total operating expenses	**(13,418)**	(16,720)	(14,592)
Operating income (loss):			
Fee Timber	**6,294**	15,215	14,592
Timberland Management & Consulting	**(543)**	(883)	1,266
Real Estate	**(1,111)**	5,163	13,864
Unallocated G&A	**(3,951)**	(4,782)	(3,817)
Total operating income	**689**	14,713	25,905
Other income (expense):			
Interest expense	**(2,469)**	(2,574)	(2,691)
Interest capitalized to development projects	**1,279**	1,145	912
Interest income	**965**	1,753	1,154
Impairment of student loan auction rate securities	**(381)**	–	–
Total other income (expense)	**(606)**	324	(625)
Income before income taxes and minority interest	**83**	15,037	25,280
Income tax benefit (expense)	**61**	69	(439)
Income before minority interest	**144**	15,106	24,841
Minority interest share of ORM Timber Fund I, LP loss	**995**	402	146
Minority interest share of ORM Timber Fund II, Inc loss	**23**	–	–
Minority interest – IPMB	**–**	–	(77)
Net income	**$1,162**	$15,508	$24,910
Income allocable to general partners	**15**	199	322
Income allocable to limited partners	**1,147**	15,309	24,588
Earnings per unit:			
Basic	**$0.25**	$3.31	$5.37
Diluted	**$0.25**	$3.21	$5.23
Distributions per unit:	**$1.60**	$1.36	$1.06

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF PARTNERS' CAPITAL AND COMPREHENSIVE INCOME

Years ended December 31 (in thousands)	**General Partners**	**Limited Partners**	**Total**
December 31, 2005	$1,121	$65,284	$66,405
SAB 108 Adjustment	7	546	553
Adjusted January 1, 2006	$1,128	$65,830	$66,958
Net income and comprehensive income	322	24,588	24,910
Distributions	(64)	(4,897)	(4,961)
Equity based compensation	–	444	444
Proceeds from option exercises	–	254	254
December 31, 2006	$1,386	$86,219	$87,605
Net income and comprehensive income	199	15,309	15,508
Distributions	(83)	(6,366)	(6,449)
Equity based compensation	-	624	624
Unit repurchase	-	(1,374)	(1,374)
Proceeds from option exercises	-	730	730
December 31, 2007	$1,502	$95,142	$96,644
Net income and comprehensive income	**15**	**1,147**	**1,162**
Distributions	**(97)**	**(7,347)**	**(7,444)**
Excess tax benefit from equity-based compensation	**–**	**167**	**167**
Equity based compensation	**–**	**584**	**584**
Unit repurchase	**–**	**(3,940)**	**(3,940)**
Proceeds from option exercises	**–**	**644**	**644**
December 31, 2008	**$1,420**	**$86,397**	**$87,817**

Weighted average units outstanding:	12/31/08	12/31/07	12/31/06
Basic	**4,597**	4,680	4,642
Diluted	**4,690**	4,825	4,762

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31 (in thousands, except per unit information)	**2008**	2007	2006
Cash flows from operating activities:			
Cash received from customers	**$29,071**	$47,667	$69,548
Cash paid to suppliers and employees	**(21,281)**	(24,473)	(25,030)
Interest received	**1,025**	1,712	1,095
Interest paid, net of amounts capitalized	**(1,401)**	(2,585)	(1,795)
Income taxes paid	**(11)**	(340)	(247)
Net cash provided by operating activities	**7,403**	21,981	43,571
Cash flows from investing activities:			
Capital expenditures	**(5,166)**	(12,162)	(12,177)
Proceeds from sale of fixed assets	**41**	64	–
Redemption (purchase) of short-term investments	**26,775**	(5,775)	(10,000)
Timberland acquisition	**(904)**	–	(57,806)
Net cash provided by (used in) investing activities	**20,746**	(17,873)	(79,983)
Cash flows from financing activities:			
Cash distributions to unitholders	**(7,444)**	(6,449)	(4,961)
ORM Timber Fund I, LP capital contributions	**–**	–	46,831
ORM Timber Fund II, Inc capital contributions	**370**	–	–
ORM Timber Fund I, LP distributions	**(800)**	(480)	–
Unit repurchase	**(3,940)**	(1,374)	–
Repayment of long-term debt	**(1,342)**	(1,481)	(1,675)
Proceeds from option exercises	**644**	730	254
Excess tax benefit from equity-based compensation	**167**	–	–
Minority interest distribution	**–**	(74)	(204)
Net cash provided by (used in) financing activities	**(12,345)**	(9,128)	40,245
Net increase (decrease) in cash and cash equivalents	**15,804**	(5,020)	3,833
Cash and cash equivalents:			
Beginning of year	**2,174**	7,194	3,361
End of year	**$17,978**	$2,174	$7,194

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

Years ended December 31 (in thousands, except per unit information)	**2008**	2007	2006
Reconciliation of net income to net cash provided by operating activities:			
Net income	**$1,162**	$15,508	$24,910
Cost of land sold	**2,614**	3,854	7,709
Minority interest – IPMB	**–**	–	77
Minority interest-ORM Timber Fund I, LP	**(995)**	(402)	(146)
Minority interest-ORM Timber Fund II, Inc	**(23)**	–	–
Depreciation and amortization	**774**	777	712
Depletion	**3,915**	4,772	6,305
Deferred tax expense (benefit)	**(143)**	13	(16)
Excess tax benefit from equity-based compensation	**(167)**	–	–
Equity-based compensation	**584**	624	444
SLARS impairment	**381**	–	–
Increase (decrease) in cash from changes in operating accounts:			
Accounts receivable	**385**	676	(25)
Contracts receivable	**571**	3,666	(5,211)
Other current assets	**5**	247	(220)
Accounts payable and accrued liabilities	**(1,526)**	(551)	890
Environmental remediation	**(440)**	1,753	84
Deposits	**53**	20	27
Deferred revenue	**(63)**	(8,570)	8,534
Other long-term liabilities	**(62)**	(47)	133
Other long term assets	**384**	(360)	(636)
Other, net	**(6)**	1	–
Net cash provided by operating activities	**$7,403**	$21,981	$43,571

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

POPE RESOURCES, A DELAWARE LIMITED PARTNERSHIP

1. Summary of Significant Accounting Policies

NATURE OF OPERATIONS

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

The Partnership operates in three business segments: Fee Timber, Timberland Management & Consulting, and Real Estate. Fee Timber represents the growing and harvesting of trees from owned properties. Timberland Management & Consulting represents management, acquisition, disposition, and consulting services provided to third-party owners of timberlands and provides management services to Fund I and Fund II once timberland is acquired. Real Estate consists of obtaining entitlements for properties that have been identified as having value as developed residential or commercial property and operating the Partnership's existing commercial and residential properties in Kitsap and Pierce Counties, 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 and income between the general and limited partners is pro rata among all units outstanding. The managing general partner of the Partnership is Pope MGP, Inc. and it receives an annual management fee of $150,000 as compensation for its duties as managing general partner.

MINORITY INTERESTS

Minority Interest represents the 80% interest in Fund I and Fund II owned by third-party investors. These Funds are consolidated into Pope Resources' financial statements due to our control over these Funds (see Note 3). Minority interest-IPMB represents Pope MGP, Inc.'s interest in the Investor Portfolio Management Business (IPMB) (see Note 11) and has been classified as a current liability since the minority interest's share of income is generally distributed on an annual basis.

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 and student loan auction rate securities (SLARS). The Partnership limits its credit exposure by considering the creditworthiness of potential customers. The Partnership's allowance for doubtful accounts is $257,094 and $31,501 at December 31, 2008 and 2007, respectively.

The Partnership owns $4.0 million par value of SLARS as of December 31, 2008 with a fair value of $3.6 million. These securities were designed to provide liquidity through a monthly auction process. The auction process stopped functioning in the first quarter of 2008 and as a result this portfolio now represents a non-current asset. The Partnership is receiving monthly interest payments on these securities but there is very little market activity in the securities themselves. See Note 2 for additional information.

CONTRACTS RECEIVABLE

The Partnership sells land parcels under contracts requiring minimum cash down payments of 20% to 25% at interest rates between zero and 10% 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, 2008, minimum principal payments on contracts receivable for the next five years and thereafter are due as follows (in thousands):

2009	$477
2010	563
2011	16
2012	17
2013	268
Thereafter	130
Total	$1,471

INCOME TAXES

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

PROPERTY, EQUIPMENT, AND ROADS

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

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

Buildings and equipment consist of the following as of December 31, 2008 and 2007 (in thousands):

Description	**12/31/2008**	12/31/2007
Buildings	**$7,444**	$7,257
Equipment	**2,880**	2,763
Furniture and fixtures	**601**	574
Total	**$10,925**	$10,594
Accumulated depreciation	**(7,360)**	(7,017)
Net buildings and equipment	**$3,565**	$3,577

TIMBER

The depletion rate is calculated by dividing estimated merchantable timber inventory into the cost basis of merchantable inventory as of the beginning of the year. To calculate the depletion rate the Partnership uses a combined pool when the characteristics of the acquired timber are not significantly different from the Partnership's existing timberlands. Timber harvested by Fund I is accounted for in a separate depletion pool due to the third-party owners in Fund I. Fund II has not yet acquired any timber but when acquired this timber is also expected to be accounted for in a separate depletion pool.

LAND HELD FOR DEVELOPMENT OR SALE

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

DEFERRED REVENUE

Deferred revenue represents the unearned portion of revenue collected. The balance at December 31, 2008 of $205,000 and December 31, 2007 of $268,000 primarily represents the unearned portion of the amounts received on cell tower leases, and to a lesser extent, unearned revenue on land sales.

REVENUE RECOGNITION

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

LAND SALES

The Partnership considers the sale of land and conservation easements to be part of its normal operations and therefore recognizes revenue from the sale and cost of sales for the Partnership's basis in the property sold. Cash generated from these sales are included in cash flow from operations on the Partnership's statements of cash flows. Investments to acquire timberlands, from which the sale of land with a higher or better use is made, and the costs incurred to develop those properties are reported in investing activities. These cash outflows are often made years prior to realization through sale of the property and, in many cases, the acquisition of the timberlands occurred prior to the requirement to include cash flow statements.

EQUITY BASED COMPENSATION

Effective January 1, 2006, we adopted the provisions of Statement of Financial Accounting Standards No. 123 (revised 2004), Share Based Payment (SFAS No. 123R) using the modified prospective approach and accordingly have not restated prior period results. SFAS 123R established the accounting for equity instruments exchanged for employee services. Under SFAS 123R, share-based compensation cost is measured at the grant date based on the calculated fair value of the award. We account for equity-based compensation awarded to retirement eligible directors and employees to amortize the expense of the award on a straight-line basis over the lesser of the vesting period or the period between the grant date and eligibility for retirement.

In 2005, we adopted the 2005 Unit Incentive Plan. Following adoption of this new Plan the Board of Directors began issuing restricted units instead of unit options as its primary method of granting equity based compensation. Units issued as a result of option exercises and restricted unit grants are funded through the issuance of new units. As of December 31, 2008, total compensation expense related to non-vested awards not yet recognized was $974,000 with a weighted average 19 months remaining to vest.

COMPREHENSIVE INCOME

Comprehensive income consists of net income. The Consolidated Statements of Partners' Capital and Comprehensive Income contains the disclosure of comprehensive income.

INCOME PER PARTNERSHIP UNIT

Basic income per partnership unit is computed using the weighted average number of units outstanding during each year. Diluted income per unit is calculated by dividing net income 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. Unit equivalents are excluded from the computation if their effect is anti-dilutive. In 2008, 4,869 unit options outstanding were not included in the calculation of earnings per partnership units as they were anti-dilutive. In 2007 there were no anti-dilutive unit options and in 2006 there were 1,100 anti-dilutive unit options outstanding.

Year Ended December 31 *(in thousands)*	**2008**	2007	2006
Weighted average units outstanding:			
Basic	**4,597**	4,680	4,642
Dilutive effect of unit equivalents	**93**	145	120
Diluted	**4,690**	4,825	4,762

STATEMENTS OF CASH FLOWS

The Partnership considers all highly liquid debt instruments with maturity of three months or less when purchased to be cash equivalents. Non-cash investing activities include the following:

- $596,000 held in trust by an IRC Section 1031 exchange facilitator as of December 31, 2007 used to acquire timberlands as of March 31, 2008.
- $443,000 reclassified to accounts receivable for a cost reimbursement related to a 2007 pond construction at the Bremerton project.
- $360,000 for capital improvements accrued in 2007 and paid in 2008. This amount is partially offset by $70,000 of accrued investing activity in 2008 to be paid in 2009.
- $203,000 of long term debt incurred in 2008 relating to a cost share reimbursement to the City of Tacoma for bridge construction.

2. Cash, Cash Equivalents, and Investments

Cash, cash equivalents, and investments held at December 31, 2008 and 2007 are as follows:

	December 31, 2008		
	Amortized Cost	**Gross Unrealized Loss**	**Estimated Fair Value**
Cash and cash equivalents	**$17,978**	**$–**	**$17,978**
Securities maturing after ten years:			
Auction rate securities, non-current	**$4,000**	**$(381)**	**$3,619**

	December 31, 2007		
	Amortized Cost	**Gross Unrealized Loss**	**Estimated Fair Value**
Cash and cash equivalents	$2,174	$–	$2,174
Securities expected to be redeemed within one year:			
Auction rate securities, current	$30,775	$–	$30,775

There were no realized gains or losses in the annual periods ended December 31, 2008 and 2007.

At December 31, 2008, Pope Resources held AAA-rated Student Loan Auction Rate Securities (SLARS) with a par value of $4.0 million and an estimated fair value, based on the methodology described below, of $3.6 million. SLARS are collateralized long-term debt instruments that historically provided liquidity through a Dutch auction process that resets the applicable interest rate at pre-determined intervals, typically every 28 days. Beginning in February 2008, auctions failed for approximately $17 million in par value of SLARS we held because sell orders exceeded buy orders. When these auctions failed to clear, higher interest rates for those securities went into effect. However, the principal amount of these securities associated with these failed auctions will not be accessible until the issuer calls the security, a successful auction occurs, a buyer is found outside of the auction process, or the security matures.

FASB Statement No. 157 Fair Value Measurement (SFAS No. 157) was followed to determine the fair value of the Partnership's investments. SFAS No. 157 defines a hierarchy of three levels of evidence used to determine fair value:

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

Currently there is very little trading activity for SLARS and as a result we do not have market data available to reference for determining the fair value of our SLARS portfolio as of December 31, 2008. Additionally, there are no markets for similar instruments so that Level 2 data is also unavailable. Accordingly, the SLARS were changed from Level 1 to Level 3 within SFAS 157's valuation hierarchy since the Partnership's adoption of SFAS No. 157 on January 1, 2008. The following table provides the fair value measurements of applicable Partnership financial assets according to the levels defined in SFAS No. 157 as of December 31, 2008 and 2007:

	December 31, 2008			
	Level 1	**Level 2**	**Level 3**	**Total**
Cash and cash equivalents	**$17,978**	**–**	**$–**	**$17,978**
Auction rate securities, non-current	**–**	**–**	**3,619**	**3,619**
Total financial assets at fair value	**$17,978**	**$–**	**$3,619**	**$21,597**

	December 31, 2007			
	Level 1	**Level 2**	**Level 3**	**Total**
Cash and cash equivalents	$2,174	$–	$–	$2,174
Auction rate securities, current	30,775	–	–	30,775
Total financial assets at fair value	$32,949	$–	$–	$32,949

We identified market interest rates for similar securities and performed a discounted cash flow calculation using these alternative interest rates and made adjustments for liquidity considered appropriate in the circumstances. This method represents a Level 3 input, and represents the best evidence we have to indicate value under current market conditions. The table below summarizes the change in the consolidated balance sheet carrying value associated with Level 3 financial assets for the annual period ended December 31, 2008:

Moody's Investors Service downgraded two of the four securities in our SLARS portfolio from Aaa to A3 in February 2009. Standard and Poor's AAA rating was not changed. These two securities represent half of the par value of our remaining SLARS portfolio. The new lower rating, which occurred in February 2009, is expected to have a negative impact on the value of these securities in 2009.

	Non-current Investments
Balance at December 31, 2007	$–
Transfers into Level 3	15,850
Sales and settlements during year ended December 31, 2008	(11,850)
Total unrealized losses included in statement of earnings	(381)
Balance at December 31, 2008	**$3,619**

3. ORM Timber Fund I, LP (Fund I) and ORM Timber Fund II, Inc. (Fund II)

The Funds were formed by Olympic Resource Management LLC (ORMLLC) for the purpose of attracting investor capital to purchase timberlands. Fund I was organized as a limited partnership where the general partner is ORMLLC. Fund II was organized as a corporation and is expected to qualify as a real estate investment trust (REIT) after it acquires timberland. The objective of these Funds is to generate a return on investments through the acquisition, management, value enhancement and sale of timberland properties. Both Funds will operate for a term of ten years from the end of the drawdown period. The drawdown period for Fund I ended on August 1, 2008 and the draw down period for Fund II will end two years after the final closing of Fund II or after Fund II is fully invested, whichever occurs first.

Pope Resources and ORMLLC own 20% of each Fund and both are consolidated into the Partnership's financial statements. Fund I's statements of operations for the years ended December 31, 2008, 2007, and 2006 reflect losses of $1.3 million, $516,000 and $169,000, respectively. These losses include management fees paid to ORMLLC of $869,000, $896,000 and $117,000 for 2008, 2007, and 2006, respectively, which are eliminated in consolidation. Fund I revenue is generated primarily through the sale of logs and other forest products. Fund I commenced harvest activities in March 2007 and harvested 5,293 MBF and 5,336 MBF in 2008 and 2007, respectively.

Fund II currently has capital commitments of $46.3 million including Pope Resources' 19% and ORMLLC's 1% commitments. Activities of Fund II currently consist of seeking timberland to acquire and performing valuations and due diligence on timberland acquisition targets. Operating activities for Fund II commenced in August 2008 and the statement of operations for the period ending December 31, 2008 consists of a loss of $30,000. This loss includes reimbursable acquisition due diligence costs of $23,000 due to ORMLLC that are eliminated in consolidation.

The Partnership's consolidated financial statements include Fund I and Fund II assets and liabilities at December 31, 2008 and 2007 which are as follows:

	2008	2007
Current assets	**2,047**	550
Timber, land, and roads (net of $2,612 and $1,269 accumulated depletion)	**53,789**	56,863
Total assets	**55,836**	57,413
Current liabilities	**191**	159
Current portion of long-term debt	**76**	0
Total current liabilities	**267**	159
Long-term debt	**127**	0
Members' capital	**55,442**	57,254
Total liabilities and members' capital	**55,836**	57,413

4. Long-Term Debt

Long-term debt at December 31 consists of *(in thousands):*

	2008	2007
Mortgage note payable to an insurance company, with interest at 9.65%, collateralized by timberlands, with monthly interest payments and annual principal payments maturing April 2011	**$9,019**	$9,559
Mortgage note payable to an insurance company, with interest at 7.63%, collateralized by timberlands, with monthly interest payments and annual principal payments maturing April 2011	**20,053**	20,804
Local improvement district assessments, with interest ranging from 5.03% to 6.5%, due through 2013	**312**	364
Note payable to the City of Tacoma, with interest at 4.5%, with monthly principal and interest payments maturing January 2014	**202**	–
Total debt	**29,586**	30,727
Less current portion:	**(1,417)**	(1,342)
Total long-term debt	**$28,169**	$29,385

The Partnership's debt agreements contain covenants which require the Partnership to maintain a required cash flow coverage ratio and not to exceed a maximum debt-to-market-capitalization ratio. As of December 31, 2008, the Partnership was in compliance with its debt covenants. One of the consequences of our planned reduction in harvest is that we anticipated falling below the minimum threshold for our cash flow covenant. We alerted our mortgage lender to this and in October 2008 we received from the mortgage lender a waiver of the cash flow coverage ratio beginning with the fourth quarter of 2008, through and including the fourth quarter of 2010.

At December 31, 2008, principal payments on long-term debt for the next five years and thereafter are due as follows (in thousands):

2009	$ 1,417
2010	1,371
2011	26,576
2012	186
2013	33
Thereafter	3

The Partnership entered into a $40 million revolving line of credit with Northwest Farm Credit Services in July 2008. This unsecured revolving loan agreement matures in August 2011 and imposes maintenance of a minimum debt-to-total capitalization ratio that the Partnership passes comfortably at present. At December 31, 2008 there were no amounts owed under this credit facility. The interest rate under this credit facility uses LIBOR as a benchmark. The spread above the benchmark rate is variable depending on the interest coverage ratio but ranges from 125 to 165 basis points.

5. Fair Value of Financial Instruments

The Partnership's financial instruments include cash and cash equivalents, short-term investments, accounts receivable, and contracts receivable, for which the carrying amount of each represents fair value based on current market interest rates or their short-term nature. The fair value of fixed rate debt having a carrying value of $29.6 million and $30.7 million has been estimated based on current interest rates for similar financial instruments to be approximately $ 31.4 million and $32.5 million as of December 31, 2008 and 2007, respectively.

6. Income Taxes

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

(in thousands)	**2008**	2007	2006
Consolidated Partnership income before income taxes (less minority interest)	**$1,101**	$15,439	$25,349
Less: Income earned in entities that pass-through pre-tax earnings to the partners	**1,162**	15,867	24,134
Income (loss) subject to income taxes	**$(61)**	$(428)	$1,215

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

(in thousands)	**2008**	2007	2006
Current	**($249)**	$82	$(455)
Deferred	**143**	(13)	16
Paid in capital	**167**	–	–
Total	**$61**	$69	$(439)

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

	2008	2007	2006
Statutory tax on income	**34%**	34%	34%
Income earned in entities that pass-through pre-tax earnings to the partners	**(40%)**	(34%)	(32%)
Effective income tax rate	**(6%)**	–%	2%

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

(in thousands)	**2008**	2007
Current (included in prepaid expenses and other)	**$100**	$52
Non current (included in other assets)	**162**	67
Total	**$262**	$119

The deferred tax assets are comprised of the following:

(in thousands)	**2008**	2007
Employee-related accruals	**$205**	$17
Depreciation	**7**	67
Other	**50**	35
Total	**$262**	$119

In 2008 and 2007, the Partnership's taxable subsidiaries incurred operating losses that will generate a refund of $269,000 representing taxes paid in prior years.

7. Unit Incentive Plan

The Partnership's 2005 Unit Incentive Plan (New 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 New Plan of which there are 1,038,646 units authorized but unissued as of December 31, 2008. The Partnership issued 19,500 restricted units under the New Plan in both 2008 and 2007. The units issued in 2008 and 2007 vest over four years with 50% vesting after three years and the remaining 50% vesting after the fourth year from date of grant provided the grantee is still an employee as of the vesting date. The grantee may not transfer restricted units until the holder fulfills the vesting requirements, which last for four years.

RESTRICTED UNITS

Pope Resources changed the primary form of equity compensation from unit options to restricted units upon adoption of the New Plan. The Human Resources Committee makes awards of restricted units to directors and senior managers of the Partnership and its subsidiaries. The restricted unit grants ordinarily vest over four years and are compensatory in nature. Restricted unit awards entitle the recipient to full distribution rights during the vesting period but are restricted from disposition and may be forfeited until the units vest. The fair value, which equals the market price at date of grant, is charged to income on a straight-line basis over the vesting period.

Restricted unit activity for the three years ended December 31, 2008 was as follows:

	Units	Weighted Avg Grant Date Fair Value ($)
Outstanding December 31, 2005	20,000	33.44
Grants	19,000	34.75
Delivered	(750)	33.44
Forefeited	(1,500)	33.44
Outstanding December 31, 2006	36,750	34.10
Grants	19,500	43.20
Delivered	(448)	35.69
Surrendered for withholding taxes	(188)	35.69
Forefeited	(2,364)	37.54
Outstanding December 31, 2007	53,250	37.27
Grants	19,500	32.99
Delivered	(8,896)	33.87
Surrendered for withholding taxes	(479)	37.13
Forefeited	(1,500)	37.15
Outstanding December 31, 2008	**61,875**	36.42

UNIT OPTIONS

There were 1,038,646, 1,056,167, and 1,073,115 units available for issuance under the 2005 Unit Incentive Plan as of December 31, 2008, 2007, and 2006 respectively. Unit options have not been granted since December 2005. Units options granted prior to January 1, 2005 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. Board members 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	Exercise Price ($)
Vested December 31, 2005	200,482	16.57
Unvested December 31, 2005	77,530	13.02
Outstanding December 31, 2005	278,012	15.58
Forfeitures	(4,800)	12.00
Exercised	(19,250)	12.86
Vested	33,012	13.12
Vested December 31, 2006	213,744	16.38
Unvested December 31, 2006	39,718	13.06
Outstanding December 31, 2006	253,462	15.86
Exercised	(47,406)	15.40
Vested	33,518	12.52
Vested December 31, 2007	199,856	15.97
Unvested December 31, 2007	6,200	15.96
Outstanding December 31, 2007	206,056	15.97
Exercised	**(40,003)**	16.08
Vested	**6,200**	15.96
Outstanding and Vested December 31, 2008	**166,053**	16.08

There are no unvested unit options at December 31, 2008.

The aggregate spread between the option exercise price and unit market price (intrinsic value) of all options outstanding at December 31, 2008 was $1.9 million. The total intrinsic value of options exercised during 2008 was $388,000. The weighted average remaining contractual term for all outstanding and exercisable options at December 31, 2008 was 3.3 years.

8. Partnership Unit Repurchase Plans

The Partnership adopted a unit repurchase plan in October 2007 under which the Partnership acquired units with an aggregate market value of $5.0 million. This plan was completed in April 2008 with the purchase of 128,957 units at a weighted average unit purchase price of $38.90. The Partnership subsequently adopted a new unit repurchase plan in December 2008. Under the new plan the Partnership may repurchase limited partner units having an aggregate value of not more than $2.5 million, subject to certain conditions and other contingencies established under the plan.

The unit repurchase period commenced on December 10, 2008 and may continue for up to one year. In the fourth quarter of 2008, we purchased 15,252 units for an average cost per unit of $19.44.

9. Employee Benefits

As of December 31, 2008 all full-time employees of the Partnership and its subsidiaries are eligible to receive benefits under a defined contribution plan. During the years 2006 through 2008 the Partnership matched 50% of employees' contributions up to 8% of an individual's compensation. The Partnership's contributions to the plan amounted to $150,000, $151,000, $130,000, for the years ended December 31, 2008, 2007, and 2006 respectively.

10. Commitments and Contingencies

ENVIRONMENTAL REMEDIATION

The Partnership has an accrual for estimated environmental remediation costs of $1.6 million and $1.9 million as of December 31, 2008 and 2007, respectively. This accrual represents estimated payments to be made to remedy environmental contamination at the historic Port Gamble, Washington, townsite and millsite and to monitor results of the cleanup efforts. This contamination is believed to have occurred during the years P&T operated a mill at Port Gamble, from 1853 to 1995. At the time Pope Resources was spun off from P&T, Port Gamble was included in our assets, and after contamination was discovered at the townsite, millsite, and in the adjacent bay, we entered into a settlement and remediation agreement with P&T pursuant to which we and P&T allocated responsibility for cleanup costs. Under Washington law, both Pope Resources and P&T are "potentially liable persons" based on ownership and/or operation of the site. These laws provide for joint and several liability among parties owning or operating property on which contamination occurs, meaning that cleanup costs can be assessed against any or all such parties. Our agreement with P&T was intended to apportion responsibility based on this principle, with P&T bearing the larger share of responsibility based upon their role in operating the site and upon their relatively lengthy ownership.

Following P&T's October 2007 bankruptcy filing in Canada and a November 2007 Chapter 11 bankruptcy filing in the United States we recorded a $1.9 million charge to earnings in the fourth quarter of 2007 to increase our environmental remediation liability for Port Gamble. This charge reflects P&T's inability to complete their portion of the remediation that had not been completed. We are in active discussions with the Washington State Department of Ecology to promote protection of the environment, optimize and appropriately allocate the remaining cleanup liabilities, and maximize our control over the remediation process.

Management continues to closely monitor closely the Port Gamble cleanup process. In May 2008, a bankruptcy judge approved a request from P&T to convert the Chapter 11 reorganization to a Chapter 7 liquidation plan. This was subsequently converted to Chapter 15 in August 2008 to liquidate P&T's remaining Canadian assets. The $1.6 million remediation liability balance as of December 31, 2008 represents our best estimate of the remaining cleanup cost and most likely outcome to various contingencies within the overall project. The range of potential liabilities is $816,000 to $4.5 million which represents the range of two standard deviations from the mean of possible outcomes generated by the statistical modeling process used to estimate this liability as of December 31, 2008.

However, the balance is based upon a number of estimates and judgments that may change as the project progresses.

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 $1,067,000 and $4,995,000 outstanding at December 31, 2008 and 2007, respectively.

OPERATING LEASES

The Partnership has non-cancelable operating leases for automobiles, office space, and computer equipment. The lease terms are from 12 to 48 months. Rent expense under the operating leases totaled $127,000, $124,000, and $115,000 for the years ended December 31, 2008, 2007 and 2006, respectively.

At December 31, 2008 future annual minimum rental payments under non-cancelable operating leases are as follows:

Year	Amount
2009	$80,000
2010	33,000
2011	30,000
2012	16,000

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 $7,000 and $19,000 in 2008 and 2007, 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, 2008 and 2007 was $186,000 and $204,000, respectively.

CONTINGENCIES

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

11. Related Party Transactions and Minority Interest

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

The minority interest-IPMB represents Pope MGP, Inc.'s profit-sharing interest in the IPMB. The 1997 amendment to the Limited Partnership Agreement authorizing management to pursue the IPMB specifies that annual net income from the IPMB will be split using a sliding scale allocation method, commencing with 80% to ORM, Inc., a subsidiary of Pope Resources, and 20% to Pope MGP, Inc. The sliding scale allocation method will allocate income evenly between ORM, Inc. and Pope MGP, Inc. once net income from the IPMB reaches $7.0 million in a fiscal year. The share of IPMB allocated to Pope MGP is further split between Pope MGP and a management incentive plan referred to as the Long-term Incentive Plan. This portion of Pope MGP's share of the IPMB is $0 in 2008 and $77,000 in 2007 and is included in Timberland Management & Consulting operating expenses. The aforementioned amendment authorizing pursuit of the IPMB limits cumulative net expenditures to $5.0 million. As of December 31, 2008, cumulative revenue from the IPMB exceeds cumulative IPMB expenditures.

12. Segment and Major Customer Information

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

The Timberland Management & Consulting segment began providing management, disposition, and technical forestry services to a client owning approximately 267,000 acres of timberland and an additional 24,000 acres for Fund I.

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 is working with 2,500 acres of early stage development properties as of December 31, 2008. All of the Partnership's real estate activities are in Washington State.

For the year ended December 31, 2008, the Partnership did not have any customers that represented 10% or more of consolidated revenue. For the year ended December 31, 2007, the Partnership had one major customer that represented 14% of consolidated revenue.

Identifiable assets are those used exclusively in the operations of each industry segment or those allocated when used jointly. The Partnership does not allocate cash, accounts receivable, certain prepaid expenses, or the cost basis of the Partnership's administrative office for purposes of evaluating segment performance. Inter-segment 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)	**2008**	2007	2006
Revenue:			
Pope Resources Fee Timber	**19,282**	32,678	35,905
Timber Fund	**4,845**	3,008	–
Total Fee Timber	**24,127**	35,686	35,905
Timberland Management & Consulting	**1,890**	2,260	3,860
Real Estate	**3,723**	15,076	27,356
Total Revenue (Internal)	**29,740**	53,022	67,121
Elimination of Intersegment Revenue	**(1,562)**	(1,127)	(871)
Total Revenue (External)	**28,178**	51,895	66,250
Intersegment Revenue or Transfers			
Pope Resources Fee Timber	**(577)**	(172)	(645)
Timber Fund	**–**	–	–
Total Fee Timber	**(577)**	(172)	(645)
Timberland Management & Consulting	**(946)**	(916)	(190)
Real Estate	**(39)**	(39)	(36)
Total	**(1,562)**	(1,127)	(871)
Operating Income (Loss)			
Pope Resources Fee Timber	**7,217**	14,957	15,230
Timber Fund	**(1,278)**	(490)	(183)
Total Fee Timber	**5,939**	14,467	15,047
Timberland Management & Consulting	**138**	(174)	1,419
Real Estate	**(1,437)**	5,202	13,255
G&A	**(3,951)**	(4,782)	(3,816)
Total Operating Income (Internal)	**689**	14,713	25,905
Total Operating Income (External)	**689**	14,713	25,905
Intersegment Charges or Transfers			
Pope Resources Fee Timber	**(538)**	(133)	(585)
Timber Fund	**893**	882	130
Total Fee Timber	**355**	749	(455)
Timberland Management & Consulting	**(681)**	(787)	(153)
Real Estate	**326**	39	609
G&A	**–**	(1)	(1)
Total	**–**	–	–
Depreciation, Amortization and Depletion			
Pope Resources Fee Timber	**2,381**	3,835	6,266
Timber Fund	**1,341**	1,269	-
Total Fee Timber	**3,722**	5,104	6,266
Timberland Management & Consulting	**127**	81	73
Real Estate	**684**	201	647
G&A	**156**	185	218
Total	**4,689**	5,571	7,204

	2008	2007	2006
Assets			
Pope Resources Fee Timber	**66,183**	66,769	65,304
Timber Fund I LP	**55,380**	57,412	58,581
Timber Fund II Inc	**456**	–	–
Total Fee Timber	**122,019**	124,181	123,885
Timberland Management & Consulting	**628**	669	690
Real Estate	**21,270**	18,749	16,107
G&A	**21,494**	35,726	39,600
Total	**165,411**	179,325	180,282
Capital and Land Expenditures			
Pope Resources Fee Timber	**891**	1,172	1,138
Timber Fund	**269**	329	57,806
Total Fee Timber	**1,160**	1,501	58,944
Timberland Management & Consulting	**3**	105	2
Real Estate	**4,355**	10,164	10,919
G&A	**552**	392	118
Total	**6,070**	12,162	69,983
Revenue by product/service			
Domestic forest products	**15,691**	31,908	31,486
Export forest products, indirect	**3,427**	1,584	1,808
Conservation easements	**3,257**	–	–
Fees for service	**4,108**	4,348	6,638
Homes, lots, and undeveloped acreage	**1,695**	14,055	26,318
Total Revenue	**28,178**	51,895	66,250

13. Quarterly Financial Information (Unaudited)

(in thousands, except per unit amounts)	**Revenue**	**Income (Loss) From Operations**	**Net Income (Loss)**	**Earnings (Loss) Per Partnership Unit Basic**	**Earnings (Loss) Per Partnership Unit Diluted**
2008					
First quarter	**$6,340**	**$705**	**$941**	**$0.20**	**$0.20**
Second quarter	**11,252**	**1,615**	**1,683**	**0.37**	**0.36**
Third quarter	**7,436**	**(289)**	**(23)**	**(.00)**	**(.00)**
Fourth quarter	**3,150**	**(1,342)**	**(1,439)**	**(0.31)**	**(0.31)**
2007					
First quarter	$6,787	$688	$854	$0.18	$0.18
Second quarter	15,326	4,952	4,815	1.03	1.00
Third quarter	12,171	3,228	3,551	0.76	0.74
Fourth quarter	17,611	5,845	6,288	1.34	1.30

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, 2008 and 2007, and the related consolidated statements of operations, partners' capital and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2008. 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, 2008 and 2007, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2008, in conformity with U.S. generally accepted accounting principles.

Effective January 1, 2006, the Partnership adopted Securities and Exchange Commission Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in the Current Year Financial Statements*.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Partnership's internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee for Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 5, 2009 expressed an unqualified opinion on the effectiveness of internal control over financial reporting.

KPMG LLP
Seattle, Washington
March 5, 2009

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, internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Partnership's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Partnership's internal control over financial reporting based on our audit.

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

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

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

In our opinion, Pope Resources, A Delaware Limited Partnership, maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, 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, 2008 and 2007, and the related consolidated statements of operations, partners' capital and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2008, and our report dated March 5, 2009, expressed an unqualified opinion on those consolidated financial statements.

KPMG LLP
Seattle, Washington
March 5, 2009

RESULTS OF OPERATIONS

(Dollar amounts are in thousands except per unit data)	**2008**	2007	2006	2005
Revenue				
Fee Timber	**$23,551**	$35,514	$35,260	$44,424
Timberland Management & Consulting	**944**	1,344	3,670	7,764
Real Estate	**3,683**	15,037	27,320	4,818
Total revenue	**28,178**	51,895	66,250	57,006
Operating income/(loss)				
Fee Timber	**6,294**	15,215	14,592	16,320
Timberland Management & Consulting	**(543)**	(883)	1,266	3,540
Real Estate	**(1,111)**	5,163	13,864	1,270
General & Administrative	**(3,951)**	(4,782)	(3,817)	(3,651)
Total operating income/(loss)	**689**	14,713	25,905	17,479
Depreciation, depletion, and amortization	**4,689**	5,549	7,017	11,252
Net interest expense/(income)	**225**	(324)	625	2,477
Income tax expense/(benefit)	**(61)**	(69)	439	997
Impairment of student loan auction rate securities	**381**			
Minority interests	**(1,018)**	(402)	(69)	321
Net income/(loss)	**1,162**	15,508	24,910	13,684
PER UNIT RESULTS				
Net income/(loss)	**$0.25**	$3.21	$5.23	$2.88
Distributions	**1.60**	1.36	1.06	0.80
Partners' capital	**19.09**	20.73	18.85	14.35
Weighted average units outstanding (000)	**4,690**	4,825	4,762	4,753
CASH FLOW				
Net cash provided by operating activities	**$7,403**	$21,981	$43,571	$28,909
Investing activities (excluding short-term investments)	**6,029**	12,098	69,983	6,750
Distributions to unitholders	**7,444**	6,449	4,961	3,701
Unit repurchases	**3,940**	1,374		
Payment/(issuance) of long-term debt	1,342	1,481	1,675	1,883
Free cash flow#	1,957	11,268	25,784*	16,731
FINANCIAL POSITION				
Land and timber, net of depletion	**$137,133**	$138,112	$133,731	$78,222
Total assets	**165,411**	179,325	180,282	106,358
Long-term debt, including current portion	**29,586**	30,727	32,208	33,883
Partners' capital	**87,817**	96,644	87,605	66,405
FINANCIAL RATIOS#				
Total Debt to Total Capitalization	**25%**	24%	27%	34%
Return on Assets	**1%**	9%	17%	14%
Return on Equity	**1%**	17%	32%	23%
Enterprise value / EBITDDA	**25.0**	8.6	4.8	5.4
UNIT TRADING PRICES#				
High	**$43.81**	$50.01	$36.00	$56.85
Low	**15.00**	34.25	30.00	19.35
Year-end close	**20.00**	42.75	34.32	31.02
Market capitalization (year end – $millions)	**92**	199	159	144
Enterprise value (year end – $millions)	**104**	197	159	159
Fee timber harvest (MMBF)	**37.7**	55.1	54.5	74.2
Average per MBF log revenue#	**506**	607	611	576
Employees at December 31 (full time equivalent)#	**51**	58	60	65

Definitions

EBITDDA = Net income before interest expense, interest income, taxes, depreciation, depletion, and amortization

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

Total Debt to Total Capitalization = Long-term debt plus current portion of long-term debt divided by total debt plus partners' capital

Debt to EBITDDA = Long-term debt, including current portion, divided by EBITDDA

EBITDDA to Interest Expense = EBITDDA divided by interest expense, including capitalized interest

Return on Assets = Net income divided by the average of beginning and ending total assets

2004	2003	2002	2001	2000	1999	1998
$33,571	$22,916	$23,298	$24,999	$21,444	$23,467	$20,985
1,601	2,386	7,295	9,703	11,011	11,705	8,906
4,476	1,734	1,599	13,143	18,202	15,681	13,061
39,648	27,036	32,192	47,845	50,657	50,853	42,952
15,126	9,669	10,199	9,190	12,113	13,020	11,560
(598)	272	919	1,685	152	1,877	3,224
1,586	(476)	(1,667)	(2,709)	(10,888)	(95)	2,527
(2,986)	(2,842)	(3,864)	(5,110)	(7,254)	(8,122)	(6,948)
13,128	6,623	5,587	3,056	(5,877)	6,680	10,363
5,752	3,546	3,864	7,698	2,899	2,683	2,053
2,952	2,806	2,894	2,961	700	1,039	788
–	242	(788)	356	(326)	259	310
–	47	147	171	–	316	256
10,176	3,528	3,334	(432)	(6,251)	5,066	8,792
$2.22	$0.78	$0.74	$(0.10)	$(1.38)	$1.11	$1.94
0.44	0.24	0.10	–	0.40	0.40	0.40
12.01	10.19	9.65	8.98	9.12	10.91	10.16
4,594	4,522	4,520	4,526	4,528	4,548	4,534
$17,854	$8,641	$9,005	$11,237	$9,973	$8,347	$9,152
24,500	2,000	1,676	46,392	2,539	3,764	5,582
1,989	1,084	452	–	1,811	1,810	2,260
1,979	1,662	1,110	(26,540)	424	497	2,594
10,898*	3,595	4,119	2,588*	(6,603)	5,983	3,805
$87,517	$69,003	$70,495	$71,549	$25,411	$28,002	$27,973
94,868	86,308	86,788	84,187	60,857	66,880	62,706
35,766	37,745	39,239	39,667	13,127	13,688	14,200
54,533	46,036	43,598	40,673	41,280	49,302	45,896
40%	45%	47%	49%	24%	22%	24%
11%	4%	4%	-1%	-10%	8%	15%
20%	8%	8%	-1%	-14%	11%	21%
6.5	8.7	9.9	10.4	(42.8)	16.5	12.8
$25.25	$15.99	$15.50	$24.50	$25.75	$35.00	$32.50
15.00	7.00	9.30	14.00	18.88	27.88	24.06
25.00	15.43	10.11	14.75	24.50	29.25	32.50
113	70	46	67	111	132	147
148	97	78	105	114	141	158
60.3	45.0	45.1	36.3	37.3	42.0	38.9
529	476	488	503	549	542	500
49	48	79	123	241	257	157

(Definitions continued)

Return on Equity = Net income divided by the average of beginning and ending partners' capital

Enterprise value / EBITDDA = Average of beginning and ending enterprise value divided by EBITDDA

Weighted Average Units Outstanding = Weighted average units outstanding for the year plus the effect of dilutive unit options outstanding

Enterprise value = market capitalization less cash plus total debt outstanding

Footnotes

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

\# *Unaudited*

Unitholder Information

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