

Wells Timberland REIT, Inc.  
Form 424B3  
August 12, 2009  
Table of Contents

**Filed Pursuant To  
Rule 424 (b) (3)  
Registration No: 333-157087**

**WELLS TIMBERLAND REIT, INC.**

**SUPPLEMENT NO. 1 DATED AUGUST 12, 2009**

**TO THE PROSPECTUS DATED AUGUST 6, 2009**

This document supplements, and should be read in conjunction with, our prospectus dated August 6, 2009, relating to our offering of up to \$2,200,000,000 of common stock. Defined terms used in this supplement have the same meanings as set forth in the prospectus. The purpose of this supplement is to disclose:

the status of our public offerings;

increased suitability standards for investors in the state of Tennessee;

clarifications to certain risk factors;

clarifications to the disclosure in the section of the prospectus entitled "Business and Policies," "Investment Objectives;" and

our Quarterly Report on Form 10-Q for the quarter ended June 30, 2009, as filed with the Securities and Exchange Commission on August 7, 2009, which is attached to this supplement as Annex A.

**Status of Our Public Offerings**

As of August 7, 2009, we had received aggregate gross offering proceeds, net of discounts, of approximately \$173.1 million from the sale of approximately 17.4 million shares in our initial public offering. As of August 7, 2009, approximately 57.6 million shares remained available for sale to the public under our initial public offering, exclusive of shares available under our distribution reinvestment plan.

On August 11, 2009, we stopped offering shares of our common stock in our initial public offering and on August 12, 2009, we began to accept subscriptions for shares of our common stock in this offering.

As of August 12, 2009, we had not yet received any offering proceeds in this offering. As of August 12, 2009, \$2.0 billion shares are available for sale to the public under this offering, exclusive of shares available under our distribution reinvestment plan.

**Increased Suitability Standard**

**Tennessee** Investors who reside in the state of Tennessee must have a minimum annual gross income of \$200,000 and a minimum net worth of \$200,000, or a minimum net worth of \$500,000 exclusive of home, home furnishings and automobiles. In addition, the maximum investment in us and our affiliated programs cannot exceed 10% of your net worth.

**Clarification of Risk Factors**

Edgar Filing: Wells Timberland REIT, Inc. - Form 424B3

The second bulleted risk factor on the front cover of the prospectus is hereby amended and restated to read as follows:

---

**Table of Contents**

We have a very limited operating history, have an accumulated deficit of approximately \$80.7 million as of June 30, 2009, have only completed one timberland acquisition and have not identified any additional properties to acquire with the proceeds from this offering, which make our future performance and the performance of your investment difficult to predict.

The second risk factor in the section of the prospectus entitled **Risk Factors – Risks Related to Investing in this Offering** is hereby amended and restated to read as follows:

***We have a very limited operating history, which makes our future performance and the performance of your investment difficult to predict.***

We have a very limited operating history. We were incorporated in September 2005, commenced operations in July 2007 and completed our first and only timberland investment in October 2007. See **Timberland Investments – Mahrt Timberland**. For the years ended December 31, 2007 and 2008, and for the six months ended June 30, 2009, our operations resulted in an operating loss of approximately \$4.4 million, \$13.8 million and \$2.3 million, respectively, and a net loss of approximately \$17.3 million, \$53.3 million and \$9.4 million, respectively, as well as an accumulated deficit of approximately \$18.0 million, \$71.3 million and \$80.7 million, respectively. For the years ending December 31, 2007 and 2008, our operations resulted in a negative operating cash flow of approximately \$3.4 million and \$6.6 million, respectively, and positive operating cash flow of \$4.6 million for the six months ended June 30, 2009. For the years ended December 31, 2007 and 2008, and for the six months ended June 30, 2009, we incurred interest expense on our indebtedness of approximately \$13.7 million, \$42.3 million and \$5.8 million, respectively, and accrued but unpaid dividends payable on our preferred stock of approximately \$0.6 million, \$3.0 million and \$1.8 million, respectively. See **Selected Financial Data**. Our lack of operating history significantly increases the risk and uncertainty you face in making an investment in our shares, including related to our ability to pay distributions in the future. You should not rely upon the past performance of other Wells-sponsored real estate programs. Such past performance was not related to the ownership of timberland property and would not predict our future results.

The second risk factor in the section of the prospectus entitled **Risk Factors – Federal Income Tax Risks** is hereby amended and restated to read as follows:

***We have not qualified as a REIT and may fail to meet the requirements to qualify as a REIT, which will require us to pay additional taxes and which could reduce our funds available to make distributions to our stockholders.***

We are not qualified as a REIT currently and are subject to federal and state and local taxes on our taxable income. We intend to elect to be taxed as a REIT commencing with the taxable year ending December 31, 2009. However, because our ability to do so is subject to the satisfaction of certain organizational and operational requirements which depends on the results of future operations, we cannot give any assurances regarding when, if ever, we will qualify or elect to be taxed as a REIT. Our qualification as a REIT will depend upon our ability to meet, on an ongoing basis, these requirements regarding our organization and ownership, distributions of our income, the nature and diversification of our income and assets, and other tests imposed by the Internal Revenue Code. We have no assurances that we will satisfy the requirements for REIT qualification now or in the future. Alston & Bird LLP, our legal counsel, will not review our compliance with the REIT qualification standards on an ongoing basis. Future legislative, judicial or administrative changes to the federal income tax laws could be applied retroactively, which could result in our disqualification as a REIT.

**Table of Contents**

The terms of our mezzanine and senior loan agreements prohibit us from paying distributions until we repay the mezzanine loan (which matures on April 30, 2010) and attain certain financial performance measures under the senior loan. If we elect to be taxed as a REIT for the taxable year ending December 31, 2009, and if we have taxable income for the taxable year ending December 31, 2010 but are unable to pay distributions due to the terms of our mezzanine and senior loan agreements, we could fail to qualify to be taxed as a REIT for the taxable year ending December 31, 2010. If we fail to qualify as a REIT for any taxable year, we will be subject to federal income tax on our taxable income at corporate rates. In addition, we would generally be disqualified from treatment as a REIT for the four taxable years following the year of losing our REIT status. Losing our REIT status would reduce our net earnings available for investment or distribution to stockholders because of the additional tax liability. In addition, distributions to stockholders would no longer qualify for the dividends paid deduction, and we would no longer be required to make distributions. If this occurs, we might be required to borrow funds or liquidate some investments in order to pay the applicable tax.

**Clarification of Business and Policies Investment Objectives**

The first sentence immediately following the list of our primary investment objectives in the section of the prospectus entitled Business and Policies Investment Objectives is hereby amended and restated to read as follows:

As of the date of this prospectus, we have not paid any cash distributions to our stockholders and we will not be able to pay any cash distributions until we repay the mezzanine loan or renegotiate its terms, and attain certain financial performance measures under the senior loan.

**Table of Contents**

**ANNEX A**

**QUARTERLY REPORT ON FORM 10-Q**

**FOR THE**

**QUARTERLY PERIOD ENDED JUNE 30, 2009**

- 4 -

Table of Contents

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

**Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended June 30, 2009**

OR

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

Commission file number 000-53193

**WELLS TIMBERLAND REIT, INC.**

(Exact name of registrant as specified in its charter)

**Maryland**  
(State or other jurisdiction of incorporation or organization)

6200 The Corners Parkway

Norcross, Georgia 30092

**20-3536671**  
(I.R.S. Employer Identification Number)

Edgar Filing: Wells Timberland REIT, Inc. - Form 424B3

(Address of principal executive offices)

(Zip Code)

(770) 449-7800

(Registrant's telephone number, including area code)

N/A

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

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

Yes  No

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

Yes  No

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

Yes  No

**Number of shares outstanding of the registrant's only**

**class of common stock, as of July 31, 2009: 17,206,571 shares**

**Table of Contents**

**FORM 10-Q**

**WELLS TIMBERLAND REIT, INC.**

**TABLE OF CONTENTS**

	<b>Page No.</b>
<b>PART I. <u>FINANCIAL INFORMATION</u></b>	
Item 1. <u>Condensed Consolidated Financial Statements</u>	4
<u>Consolidated Balance Sheets as of June 30, 2009 (unaudited) and December 31, 2008</u>	5
<u>Consolidated Statements of Operations for the Three Months and Six Months Ended June 30, 2009 (unaudited) and 2008 (unaudited)</u>	6
<u>Consolidated Statements of Stockholders' Equity for the Year Ended December 31, 2008 and the Six Months Ended June 30, 2009 (unaudited)</u>	7
<u>Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2009 (unaudited) and 2008 (unaudited)</u>	8
<u>Condensed Notes to Consolidated Financial Statements (unaudited)</u>	9
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	22
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	34
Item 4T. <u>Controls and Procedures</u>	35
<b>PART II. <u>OTHER INFORMATION</u></b>	
Item 1. <u>Legal Proceedings</u>	35
Item 1A. <u>Risk Factors</u>	35
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	35
Item 3. <u>Defaults Upon Senior Securities</u>	36
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	36
Item 5. <u>Other Information</u>	36
Item 6. <u>Exhibits</u>	38



**Table of Contents**

**CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

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

Any such forward-looking statements are subject to unknown risks, uncertainties, and other factors and are based on a number of assumptions involving judgments with respect to, among other things, future economic, competitive, and market conditions, all of which are difficult or impossible to predict accurately. To the extent that our assumptions differ from actual results, our ability to meet such forward-looking statements, including our ability to generate positive cash flow from operations, make distributions to stockholders, and maintain the value of our real estate properties, may be significantly hindered. See Item 1A herein, as well as Item 1A in Wells Timberland REIT s Annual Report on Form 10-K for the year ended December 31, 2008, as amended, for a discussion of some of the risks and uncertainties, although not all, of the risks and uncertainties, that could cause actual results to differ materially from those presented in our forward-looking statements.

**Table of Contents**

**PART I. FINANCIAL INFORMATION**

**ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

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

The accompanying consolidated financial statements should be read in conjunction with the condensed notes to Wells Timberland REIT's financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations included in this quarterly report on Form 10-Q and with Wells Timberland REIT's Annual Report on Form 10-K for the year ended December 31, 2008, as amended. Wells Timberland REIT's results of operations for the three months and six months ended June 30, 2009 are not necessarily indicative of the operating results expected for the full year.

**Table of Contents****WELLS TIMBERLAND REIT, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

	(Unaudited) June 30, 2009	December 31, 2008
<b>Assets:</b>		
Cash and cash equivalents	\$ 4,854,261	\$ 4,120,091
Restricted cash and cash equivalents	7,549,108	7,331,910
Accounts receivable	1,598,903	767,611
Prepaid expenses and other assets	798,136	784,448
Deferred financing costs, less accumulated amortization of \$9,139,947 and \$8,426,956 as of June 30, 2009 and December 31, 2008, respectively	1,297,487	2,010,478
Timber assets, at cost:		
Timber and timberlands, net (Note 3)	363,845,049	375,139,886
Intangible lease assets, less accumulated amortization of \$287,573 and \$204,353 as of June 30, 2009 and December 31, 2008, respectively	749,280	832,500
<b>Total assets</b>	<b>\$ 380,692,224</b>	<b>\$ 390,986,924</b>
<b>Liabilities:</b>		
Accounts payable and accrued expenses	\$ 2,457,315	\$ 3,391,893
Due to affiliates (Note 7)	15,886,868	12,790,206
Other liabilities	8,439,047	8,197,438
Notes payable:		
Senior loan (Note 4)	202,396,946	208,600,930
Mezzanine loan (Note 4)	39,994,110	65,731,749
<b>Total liabilities</b>	<b>269,174,286</b>	<b>298,712,216</b>
<b>Commitments and Contingencies (Note 5)</b>		
<b>Stockholders Equity:</b>		
Preferred stock, \$0.01 par value; 100,000,000 shares authorized:		
8.5% Series A preferred stock, \$1,000 liquidation preference; 32,128 shares issued and outstanding as of June 30, 2009 and December 31, 2008	36,842,717	35,488,500
8.5% Series B preferred stock, \$1,000 liquidation preference; 10,700 shares issued and outstanding as of June 30, 2009 and December 31, 2008	11,462,485	11,011,473
Common stock, \$0.01 par value; 900,000,000 shares authorized; 16,592,571 and 13,412,781 shares issued and outstanding as of June 30, 2009 and December 31, 2008, respectively	165,926	134,128
Additional paid-in capital	143,706,547	116,930,362
Accumulated deficit	(80,659,737)	(71,289,755)
<b>Total stockholders equity</b>	<b>111,517,938</b>	<b>92,274,708</b>
<b>Total liabilities and stockholders equity</b>	<b>\$ 380,692,224</b>	<b>\$ 390,986,924</b>

*See accompanying notes.*

**Table of Contents****WELLS TIMBERLAND REIT, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS**

	(Unaudited)		(Unaudited)	
	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2009	2008	2009	2008
<b>Revenues:</b>				
Timber sales	\$ 11,258,679	\$ 9,954,766	\$ 21,009,700	\$ 20,506,132
Timberland sales	144,498		5,024,208	4,024,273
Other revenues	873,231	650,041	1,692,995	1,343,204
	<b>12,276,408</b>	<b>10,604,807</b>	<b>27,726,903</b>	<b>25,873,609</b>
<b>Expenses:</b>				
Contract logging and hauling costs	5,526,807	4,960,018	10,127,923	10,155,145
Depletion	4,525,655	5,022,884	8,653,024	10,512,082
Cost of timberland sales	65,943		3,416,263	2,557,581
General and administrative expenses	861,289	1,176,258	1,893,769	2,349,942
Asset and forestry management fees:				
Related-party	992,407	998,993	1,990,119	2,005,790
Other	768,940	921,400	1,543,065	1,425,678
Land rent expense	568,243	636,639	1,163,679	1,240,676
Other operating expenses	743,617	1,301,722	1,253,540	1,568,103
	<b>14,052,901</b>	<b>15,017,914</b>	<b>30,041,382</b>	<b>31,814,997</b>
<b>Operating loss</b>	<b>(1,776,493)</b>	<b>(4,413,107)</b>	<b>(2,314,479)</b>	<b>(5,941,388)</b>
<b>Other income (expense):</b>				
Interest income	6,855	2,913,268	24,623	7,811,080
Interest expense	(2,677,038)	(10,816,379)	(5,806,561)	(23,902,025)
Gain (loss) on interest rate swaps	(379,030)	2,899,199	(1,273,565)	(2,169,359)
	<b>(3,049,213)</b>	<b>(5,003,912)</b>	<b>(7,055,503)</b>	<b>(18,260,304)</b>
<b>Net loss</b>	<b>(4,825,706)</b>	<b>(9,417,019)</b>	<b>(9,369,982)</b>	<b>(24,201,692)</b>
<b>Dividends to preferred stockholders</b>	<b>(907,602)</b>	<b>(678,989)</b>	<b>(1,805,229)</b>	<b>(1,357,978)</b>
<b>Net loss available to common stockholders</b>	<b>\$ (5,733,308)</b>	<b>\$ (10,096,008)</b>	<b>\$ (11,175,211)</b>	<b>\$ (25,559,670)</b>
<b>Per-share information basic and diluted:</b>				
Net loss available to common stockholders	\$ (0.36)	\$ (1.32)	\$ (0.75)	\$ (3.95)
<b>Weighted-average common shares outstanding basic and diluted</b>	<b>15,715,827</b>	<b>7,670,120</b>	<b>14,897,626</b>	<b>6,465,875</b>

*See accompanying notes.*

Table of Contents

**WELLS TIMBERLAND REIT, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**  
**FOR THE YEAR ENDED DECEMBER 31, 2008**  
**AND THE SIX MONTHS ENDED JUNE 30, 2009 (UNAUDITED)**

	Common Stock		Preferred Stock		Additional Paid-In Capital	Accumulated Deficit	Total Stockholders Equity
	Shares	Amount	Shares	Amount			
<b>Balance, December 31, 2007</b>	4,320,101	\$ 43,201	32,128	\$ 32,757,620	\$ 38,258,080	\$ (18,015,073)	\$ 53,043,828
Issuance of common stock	9,122,680	91,227			91,135,198		91,226,425
Redemption of common stock	(30,000)	(300)			(299,700)		(300,000)
Issuance of preferred stock			10,700	10,700,000			10,700,000
Dividends on preferred stock				3,042,353	(3,042,353)		
Commissions and discounts on stock sales and related dealer-manager fees					(8,027,535)		(8,027,535)
Other offering costs					(1,093,328)		(1,093,328)
Net loss						(53,274,682)	(53,274,682)
<b>Balance, December 31, 2008</b>	13,412,781	134,128	42,828	46,499,973	116,930,362	(71,289,755)	92,274,708
<b>Issuance of common stock</b>	<b>3,187,010</b>	<b>31,870</b>			<b>31,838,226</b>		<b>31,870,096</b>
<b>Redemption of common stock</b>	<b>(7,220)</b>	<b>(72)</b>			<b>(72,126)</b>		<b>(72,198)</b>
<b>Dividends on preferred stock</b>				<b>1,805,229</b>	<b>(1,805,229)</b>		
<b>Commissions and discounts on stock sales and related dealer-manager fees</b>					<b>(2,804,568)</b>		<b>(2,804,568)</b>
<b>Other offering costs</b>					<b>(380,118)</b>		<b>(380,118)</b>
<b>Net loss</b>						<b>(9,369,982)</b>	<b>(9,369,982)</b>
<b>Balance, June 30, 2009</b>	<b>16,592,571</b>	<b>\$ 165,926</b>	<b>42,828</b>	<b>\$ 48,305,202</b>	<b>\$ 143,706,547</b>	<b>\$ (80,659,737)</b>	<b>\$ 111,517,938</b>

*See accompanying notes.*

**Table of Contents****WELLS TIMBERLAND REIT, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS**

	(Unaudited)	
	Six Months Ended	
	June 30,	
	2009	2008
<b>Cash Flows from Operating Activities:</b>		
Net loss	\$ (9,369,982)	\$ (24,201,692)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depletion	8,653,024	10,512,082
Unrealized (gain) loss on interest rate swaps	(1,299,767)	365,252
Other amortization	93,140	83,220
Noncash interest expense	712,991	4,188,294
Basis of timberland sold	3,228,363	2,341,100
Basis of timber on terminated lease	84,375	
Changes in assets and liabilities:		
Increase in accounts receivable	(831,292)	(54,879)
(Increase) decrease in prepaid expenses and other assets	(13,688)	2,510,786
Decrease in accounts payable and accrued expenses	(934,578)	(1,814,647)
Increase in due to affiliates	2,722,348	3,330,672
Increase in other liabilities	1,541,376	1,396,733
Net cash provided by (used in) operating activities	4,586,310	(1,343,079)
<b>Cash Flows from Investing Activities:</b>		
Investment in timber, timberland, and related assets	(680,844)	(636,078)
Net funds (invested in) released from escrow accounts	(217,198)	1,212,850
Net cash (used in) provided by investing activities	(898,042)	576,772
<b>Cash Flows from Financing Activities:</b>		
Repayments of mezzanine loan	(25,737,639)	(36,538,882)
Repayments of senior loan	(6,203,984)	(2,768,410)
Issuance of common stock	31,676,499	47,335,104
Redemption of common stock	(72,198)	(300,000)
Commissions on stock sales and related dealer-manager fees paid	(2,616,776)	(4,084,333)
Net cash (used in) provided by financing activities	(2,954,098)	3,643,479
<b>Net increase in cash and cash equivalents</b>	<b>734,170</b>	<b>2,877,172</b>
<b>Cash and cash equivalents, beginning of period</b>	<b>4,120,091</b>	<b>1,474,780</b>
<b>Cash and cash equivalents, end of period</b>	<b>\$ 4,854,261</b>	<b>\$ 4,351,952</b>

*See accompanying notes.*

**Table of Contents**

**WELLS TIMBERLAND REIT, INC. AND SUBSIDIARIES**

**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**JUNE 30, 2009 (unaudited)**

**1. Organization**

Wells Timberland REIT, Inc. ( Wells Timberland REIT ) was formed on September 27, 2005 as a Maryland corporation that intends to qualify as a real estate investment trust ( REIT ) but has not yet qualified or elected to be taxed as a REIT. Wells Timberland REIT engages in the acquisition and ownership of timberland located throughout the United States. Substantially all of Wells Timberland REIT's business is conducted through Wells Timberland Operating Partnership, L.P. ( Wells Timberland OP ), a Delaware limited partnership formed on November 9, 2005, of which Wells Timberland REIT is the sole general partner, possesses full legal control and authority over its operations, and owns 99.99% of its common units. Wells Timberland Management Organization, LLC ( Wells TIMO ), a wholly owned subsidiary of Wells Capital, Inc. ( Wells Capital ), is the sole limited partner of Wells Timberland OP. In addition, Wells Timberland OP formed Wells Timberland TRS, Inc. ( Wells Timberland TRS ), a wholly owned subsidiary organized as a Delaware corporation, on January 1, 2006. Unless otherwise noted, references herein to Wells Timberland REIT shall include Wells Timberland REIT and all of its subsidiaries, including Wells Timberland OP, and the subsidiaries of Wells Timberland OP and Wells Timberland TRS. Under an agreement (the Advisory Agreement ), Wells TIMO performs certain key functions on behalf of Wells Timberland REIT and Wells Timberland OP, including, among others, the investment of capital proceeds and management of day-to-day operations (see Note 7).

As of June 30, 2009, Wells Timberland REIT owned approximately 223,300 acres of timberland and held long-term leasehold interests in approximately 88,700 acres of additional timberland, all of which is located on the Lower Piedmont and Upper Coastal Plains of East Central Alabama and West Central Georgia (the Mahrt Timberland ). Wells Timberland REIT acquired the Mahrt Timberland on October 9, 2007. Wells Timberland REIT generates the majority of its revenues from selling the rights to access land and harvest timber to third parties pursuant to supply agreements and through open-market sales, selling higher and better use timberlands ( HBU ), and leasing land-use rights to third parties. Wells Timberland REIT also generates additional revenues and income from selling the rights to extract natural resources, other than timber, from its timberland.

On August 11, 2006, Wells Timberland REIT commenced its initial public offering (the Initial Public Offering ) of up to 85.0 million shares of common stock, of which 10.0 million shares were reserved for issuance through Wells Timberland REIT's distribution reinvestment plan, pursuant to a Registration Statement filed on Form S-11 under the Securities Act of 1933. Wells Timberland REIT began actively selling its common shares in May 2007. Wells Timberland REIT commenced operations after receiving and accepting subscriptions in its Initial Public Offering equal to the minimum offering of \$2.0 million on July 11, 2007. As of June 30, 2009, Wells Timberland REIT has raised gross offering proceeds from the sale of common stock under the Initial Public Offering of approximately \$165.4 million. After deductions from such gross offering proceeds for payments of selling commissions and dealer-manager fees of approximately \$13.9 million, other organization and offering expenses of approximately \$0.2 million, and common stock redemptions of approximately \$0.4 million under the share redemption plan, Wells Timberland REIT had received aggregate net offering proceeds of approximately \$150.9 million, which was used to partially fund the Mahrt Timberland acquisition and pay down acquisition-related debt. As of June 30, 2009, Wells Timberland REIT has incurred other organization and offering expenses of approximately \$2.0 million, a substantial portion of which has been deferred by the terms of Wells Timberland REIT's loan agreements until the mezzanine loan is repaid in full and after reduction of the senior loan to a 40% loan-to-collateral value ratio. Wells Timberland REIT's Initial Public Offering terminates on August 11, 2009.

---

**Table of Contents**

On February 3, 2009, Wells Timberland REIT filed a registration statement on Form S-11, as amended by Amendment No. 1 filed on June 19, 2009 and Amendment No. 2 filed on August 5, 2009, with the Securities and Exchange Commission ( SEC ) to register approximately 220.9 million shares of common stock, of which 200.0 million shares are to be offered in a primary offering for \$10.00 per share and 20.9 million shares of common stock are to be offered under Wells Timberland REIT 's distribution reinvestment plan for \$9.55 per share (the Follow-On Offering ). On August 6, 2009, Wells Timberland REIT 's Follow-On Offering was declared effective by the SEC and Wells Timberland REIT commenced offering activities for the Follow-On Offering promptly thereafter. Wells Timberland REIT expects to stop offering shares for sale under its Initial Public Offering follow-on offering on August 11, 2009 and begin accepting subscriptions under the Follow-On Offering on August 12, 2009.

On July 11, 2008, Wells Timberland REIT entered into a master purchase agreement (the Master Purchase Agreement ) with Wells TIMO, Wells-DFH Timberland Nr.88 GmbH & Co. KG, a German closed-end fund (the 2008 Fund ), and Deutsche Fonds Holding AG, a corporation organized under the laws of Germany ( DFH ). DFH was not, and the 2008 Fund (prior to purchasing shares of common stock under the Master Purchase Agreement) was not, in any way affiliated with Wells Timberland REIT or its affiliates.

On April 8, 2009, Wells Timberland REIT entered into an amended and restated master purchase agreement (the Amended Master Purchase Agreement ) with Wells TIMO, DFH, the 2008 Fund and Wells-DFH Materia Nr.88 GmbH & Co. KG, a German closed-end fund (the 2009 Fund ). Pursuant to the Amended Master Purchase Agreement, Wells Timberland REIT has agreed to sell up to 53.8 million shares of its common stock to the 2009 Fund, at a price per share of \$9.30, for an aggregate purchase price of up to \$500.0 million (the German Offering ). In Wells Timberland REIT 's Initial Public Offering, shares of Wells Timberland REIT 's common stock are typically sold to investors at a price per share of \$10.00 and, after the application of the 7.0% sales commission and the 1.8% dealer-manager fee, Wells Timberland REIT receives net proceeds (before expenses) of \$9.12 per share. In the German Offering, Wells Timberland REIT is selling shares of its common stock to the 2009 Fund at a price per share of \$9.30. The 2009 Fund will not pay the sales commission or the dealer-manager fee in connection with the German Offering; however, Wells Timberland REIT will pay DFH a distribution fee of 1.0% of the gross proceeds that it receives from the German Offering. As a result, in respect of those shares of Wells Timberland REIT 's common stock sold in the German Offering, Wells Timberland REIT will receive net proceeds (before expenses) of \$9.21 per share, which is greater than the \$9.12 per share that Wells Timberland REIT receives in its Initial Public Offering after deducting the sales commission and dealer-manager fee. Wells Timberland REIT may increase, in its sole discretion, the size of the German Offering up to a maximum of 107.5 million shares of its common stock to accommodate any additional German closed-end fund(s) or other investment vehicles that may become a party to the Amended Master Purchase Agreement in the future (together with the 2009 Fund, the Funds ). The Funds ' right to purchase shares pursuant to the Amended Master Purchase Agreement will continue until the earlier of (i) the sale of all of the shares contemplated thereby or (ii) December 31, 2010. The German Offering is being conducted pursuant to Regulation S under the Securities Act of 1933, as amended, and is separate and in addition to Wells Timberland REIT 's Initial Public Offering. As of June 30, 2009, Wells Timberland REIT had received net proceeds from the sale of its common stock under the German Offering of \$5,000.

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



---

## **Table of Contents**

Wells Timberland REIT has various debt facilities outstanding as of June 30, 2009, which require interest and certain mandatory principal reduction payments during 2009 and 2010 (see Note 4). Wells Timberland REIT expects to generate sufficient cash flow from operations and its equity offerings to meet all such required principal and interest payment requirements. If proceeds raised in Wells Timberland REIT's equity offerings are not sufficient to cover the principal reduction payments required by the debt facilities, or if Wells Timberland REIT is not successful in extending the principal reduction dates beyond 2009, or otherwise unable to satisfy its obligations under the debt facilities as they become due, Wells Real Estate Funds Inc. ( "Wells REF" ), the guarantor of Wells Timberland REIT's mezzanine loan, has represented to Wells Timberland REIT its intent to fund any and all of Wells Timberland REIT's remaining unpaid debt maturities of the mezzanine loan in 2009 to ensure that Wells Timberland REIT makes all such debt repayments in accordance with the terms of the mezzanine loan agreement, and any repayment of such debt from Wells Timberland REIT to Wells REF would not become due or payable during 2009 or shortly thereafter.

## **2. Summary of Significant Accounting Policies**

### *Basis of Presentation*

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

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

For further information, refer to the financial statements and footnotes included in Wells Timberland REIT's Annual Report on Form 10-K for the year ended December 31, 2008, as amended.

### *Interest Rate Swap Agreements*

Wells Timberland REIT has entered into interest rate swaps agreements to hedge its exposure to changing interest rates on variable rate debt instruments. Wells Timberland REIT does not enter into derivative or interest rate transactions for speculative purposes; however, certain of its derivatives may not qualify for hedge accounting treatment. Wells Timberland REIT records the fair value of its interest rate swaps as either prepaid expenses and other assets or other liabilities in the accompanying consolidated balance sheets. Changes in the fair value of the effective portion of interest rate swaps that are designated as hedges are recorded as other comprehensive loss in the accompanying consolidated statement of stockholders' equity. The ineffective portion of the hedge, if any, is recognized in current earnings during the period of change in fair value. Changes in the fair value of interest rate swaps that do not qualify for hedge accounting treatment are recorded as gain (loss) on interest rate swaps in the accompanying consolidated statements of operations. Amounts received or paid under interest rate swaps are recorded as gain or loss on interest rate swaps as incurred. As of June 30, 2009 and December 31, 2008, Wells Timberland REIT recognized the fair value of interest rate swaps of approximately \$5.8 million and \$7.1 million, respectively, in other liabilities. A net increase (decrease) in the fair value of interest rate swaps that do not qualify for hedge accounting treatment of approximately \$1.3 million and \$(0.4) million is included in gain (loss) on interest rate swaps in the

---

**Table of Contents**

accompanying consolidated statements of operations for the six months ended June 30, 2009 and 2008, respectively.

During the three months ended June 30, 2009 and 2008, net payments of approximately \$1.3 million and \$1.1 million, respectively, are included in gain (loss) on interest rate swaps in the accompanying consolidated statements of operations. During the six months ended June 30, 2009 and 2008, net payments of approximately \$2.6 million and \$1.8 million, respectively, are included in gain (loss) on interest rate swaps in the accompanying consolidated statements of operations.

*Income Taxes*

Wells Timberland REIT was organized as a C corporation for the year ended December 31, 2008. Wells Timberland REIT intends to elect to be taxed as a REIT under the Internal Revenue Code of 1986, as amended, and has operated as such, beginning with its taxable year ending December 31, 2009. To qualify as a REIT, Wells Timberland REIT must meet certain organizational and operational requirements, including a requirement to distribute at least 90% of its ordinary taxable income to its stockholders. As a REIT, Wells Timberland REIT generally will not be subject to federal income tax on taxable income it distributes to stockholders. If Wells Timberland REIT fails to qualify as a REIT in any taxable year, it will then be subject to federal income taxes on its taxable income at regular corporate rates and will not be permitted to qualify for treatment as a REIT for federal income tax purposes for four years following the year during which qualification is lost unless the Internal Revenue Service ( IRS ) grants Wells Timberland REIT relief under certain statutory provisions.

Wells Timberland REIT intends, upon its qualification as and election to be taxed as a REIT, to treat Wells Timberland TRS as a taxable REIT subsidiary. At the point in time at which Wells Timberland REIT elects to be treated as a REIT, it may be beneficial for Wells Timberland REIT to perform certain non-customary services, including real estate or non-real estate related services, through Wells Timberland TRS. Earnings from services performed through Wells Timberland TRS are subject to federal and state income taxes irrespective of the dividends paid deduction available to REITs for federal income tax purposes. In addition, for Wells Timberland REIT to qualify as a REIT, Wells Timberland REIT's investment in Wells Timberland TRS may not exceed 25% of the value of the total assets of Wells Timberland REIT.

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

*Fair Value Measurements*

Wells Timberland REIT estimates the fair value of its assets and liabilities (where currently required under GAAP) consistent with the provisions of Statement of Financial Accounting Standards ( SFAS ) No. 157, *Fair Value Measurements* ( SFAS 157 ), which became effective for financial assets and liabilities on January 1, 2008 and for non-financial and nonrecurring assets and liabilities on January 1, 2009. Under this standard, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. While various techniques and assumptions can be used to estimate fair value depending on the nature of the asset or liability, SFAS 157 provides the following fair value technique parameters and hierarchy, depending upon availability:

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

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

**Table of Contents**

Level 3 Assets or liabilities for which significant valuation assumptions are not readily observable in the market; instruments valued based on the best available data, some of which is internally-developed, and considers risk premiums that a market participant would require.

Wells Timberland REIT applied the provisions of SFAS 157 in recording its interest rate swaps at fair value. The valuation of the interest rate swaps was determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves and implied volatilities.

The following table presents information about Wells Timberland REIT's assets and liabilities measured at fair value on a recurring basis as of June 30, 2009 and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value:

	Fair Value Measurements as of June 30, 2009			
	Total	Level 1	Level 2	Level 3
<b>Liabilities:</b>				
Interest rate swaps	\$ 5,798,749	\$	\$ 5,798,749	\$
<i>Recent Accounting Pronouncements</i>				

In December 2007, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 141(R), *Business Combination* ( SFAS 141(R) ). SFAS 141(R) requires, among other things, that (i) transaction costs be expensed as incurred and (ii) preacquisition contingencies, such as environmental or legal issues, be recorded at fair value as of the acquisition date. Wells Timberland REIT adopted SFAS 141(R) on January 1, 2009 and will apply the provisions of SFAS 141(R) to its future acquisitions.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements* ( SFAS 160 ). SFAS 160 requires, among other things, for (i) noncontrolling ownership interests to be classified as equity, instead of as a minority interest component of mezzanine equity, and (ii) earnings from noncontrolling interests to be included in earnings from consolidated subsidiaries with an additional disclosure of the allocation of such earnings between controlling and noncontrolling interests on the face of the statement of operations. Wells Timberland REIT adopted SFAS 160 on January 1, 2009. The adoption of SFAS 160 did not have a material impact on Wells Timberland REIT's consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities – an amendment to FASB Statement No. 133* ( SFAS 161 ). SFAS 161 requires additional disclosures about an entity's derivative and hedging activities including: (i) descriptions of how and why the entity uses derivative instruments, (ii) how such instruments are accounted for under SFAS 133, and (iii) how derivative instruments affect the entity's financial position, operations, and cash flows. Wells Timberland REIT adopted SFAS 161 on January 1, 2009. The adoption of SFAS 161 did not have a material impact on Wells Timberland REIT's consolidated financial statements (see *Interest Rate Swap Agreements* in Note 2 for additional required disclosures).

In April 2009, the FASB issued FASB Staff Position ( FSP ) SFAS 157-4, *Determining Fair Value when the Volume and Level of Activity for the Asset or Liability have Significantly Decreased and Identifying Transactions that are not Orderly* ( FSP 157-4 ). FSP 157-4 affirms that the objective of fair value when the market for an asset is not active is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date under current market conditions. The FSP provides guidance for estimating fair value when the volume and level of market activity for an asset or liability have significantly decreased and determining whether a transaction was orderly. This FSP applies to all fair value measurements when appropriate. Wells Timberland REIT adopted

---

**Table of Contents**

FSP 157-4 on April 1, 2009. The adoption of FSP 157-4 did not have a material impact on Wells Timberland REIT's consolidated financial statements.

In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* ( FSP 115-2 ). FSP 115-2 amends existing guidance for determining whether an other-than-temporary impairment of debt securities has occurred. Among other changes, the FASB replaced the existing requirement that an entity's management assert it has both the intent and ability to hold an impaired security until recovery with a requirement that management assert (a) it does not have the intent to sell the security, and (b) it is more likely than not it will not have to sell the security before recovery of its cost basis. Wells Timberland REIT adopted FSP 115-2 on April 1, 2009. The adoption of FSP 115-2 did not have a material impact on Wells Timberland REIT's consolidated financial statements.

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments* ( FSP 107-1 ). FSP 107-1 requires an entity to provide the annual disclosures required by FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, in its interim financial statements. Wells Timberland REIT adopted FSP 107-1 on April 1, 2009. The adoption of FSP 107-1 did not have a material impact on Wells Timberland REIT's consolidated financial statements or disclosures. See Note 4 for additional required disclosures.

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events* ( SFAS 165 ). SFAS 165 provides guidance on management's assessment of subsequent events. SFAS 165 clarifies U.S. auditing literature and states that management must evaluate, as of each reporting period, events or transactions that occur after the balance sheet date through the date that the financial statements are issued or are available to be issued. SFAS 165 allows the assessment of subsequent events to occur through the date on which the financial statements are available to be issued or the date they are issued; however, management must also disclose the date through which events or transactions have been evaluated. Management must perform its assessment for both interim and annual financial reporting periods. SFAS 165 is effective prospectively for interim and annual periods ending after June 15, 2009. The adoption of SFAS 165 did not have a material impact on Wells Timberland REIT's consolidated financial statements or disclosures. See Note 8 for required subsequent event disclosures.

In June 2009, the FASB issued SFAS No. 166, *Accounting for Transfers of Financial Assets – an amendment of FASB Statement No. 140* ( SFAS 166 ), which is effective for Wells Timberland REIT for the year beginning January 1, 2010. SFAS 166 amends the de-recognition guidance in SFAS 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, including eliminating the concept of a qualifying special-purpose entity. Wells Timberland REIT is currently assessing the provisions of SFAS 166 and has not yet determined the impact, if any, on its consolidated financial statements.

In June 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)* ( SFAS 167 ), which is effective for Wells Timberland REIT for the year beginning January 1, 2010. SFAS 167 amends SFAS No. 46(R), *Consolidation of Variable Interest Entities*, the consolidation guidance that applies to variable interest entities. SFAS 167 changes how a reporting entity determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a reporting entity is required to consolidate another entity is based on, among other things, the other entity's purpose and design and the reporting entity's ability to direct the activities of the other entity that most significantly impact the other entity's economic performance. Wells Timberland REIT is currently assessing the provisions of SFAS 167 and has not yet determined the impact, if any, on its consolidated financial statements.

In June 2009, the FASB issued SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles* ( SFAS 168 ). SFAS 168 requires that the FASB Accounting Standards Codification become the source of authoritative U.S. GAAP recognized by the FASB

**Table of Contents**

to be applied by nongovernmental entities. Once the Codification is in effect, all of its content will carry the same level of authority, effectively superseding SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*. SFAS 168 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. Wells Timberland REIT does not expect that the adoption of this statement will have a significant impact on its consolidated financial statements or disclosures.

**3. Timber and Timberlands**

During the three months ended June 30, 2009, Wells Timberland REIT sold approximately 50 acres of non-strategic timberland for approximately \$0.1 million. Wells Timberland REIT sold no non-strategic timberland during the three months ended June 30, 2008. During the six months ended June 30, 2009 and 2008, Wells Timberland REIT sold approximately 3,010 acres and 1,600 acres, respectively, of non-strategic timberland for approximately \$5.0 million and \$4.0 million, respectively. For the three months ended June 30, 2009, the basis in timberland sold was approximately \$50,000. The basis in timberland sold during the six months ended June 30, 2009 and 2008 was approximately \$3.2 million and \$2.3 million, respectively. As of June 30, 2009 and December 31, 2008, timber and timberlands consisted of the following, respectively:

	As of June 30, 2009		
	Gross	Depletion	Net
Timber	\$ 207,145,782	\$ 8,653,024	\$ 198,492,758
Timberlands	165,221,663		165,221,663
Mainline roads	144,433	13,805	130,628
Timber and Timberlands	\$ 372,511,878	\$ 8,666,829	\$ 363,845,049

	As of December 31, 2008		
	Gross	Depletion	Net
Timber	\$ 229,019,954	\$ 21,513,106	\$ 207,506,848
Timberlands	167,509,265		167,509,265
Mainline roads	127,658	3,885	123,773
Timber and Timberlands	\$ 396,656,877	\$ 21,516,991	\$ 375,139,886

**4. Notes Payable**

During the three months and six months ended June 30, 2009, Wells Timberland REIT engaged in the following significant activities with respect to its notes payable:

Wells Timberland REIT paid down the mezzanine loan by approximately \$14.0 million and \$25.7 million, respectively. The aggregate outstanding principal balance of the mezzanine loan as of June 30, 2009 was approximately \$40.0 million.

The credit agreement for the senior loan contains mandatory prepayment requirements from proceeds generated from dispositions of timber and timberland less a working capital reserve. During the three months and six months ended June 30, 2009, Wells Timberland REIT paid down the senior loan by approximately \$2.3 million and \$6.2 million, respectively, with proceeds from timber and timberland sales.

During the six months ended June 30, 2009 and 2008, Wells Timberland REIT made interest payments on the mezzanine loan of approximately \$3.1 million and \$7.1 million, respectively. Wells Timberland REIT made interest payments on the senior loan of approximately \$4.6 million and \$7.0 million during the six months ended June 30, 2009 and 2008, respectively.



---

## **Table of Contents**

As of June 30, 2009 and December 31, 2008, the estimated fair value of Wells Timberland REIT's notes payable was approximately \$235.2 million and \$264.0 million, respectively. The fair values of outstanding mortgage notes payable were estimated based on discounted cash flow analyses using the current market borrowing rates for similar types of borrowing arrangements as of June 30, 2009 and December 31, 2008. The discounted cash flow method of assessing fair value results in a general approximation of value, and such value may never actually be realized.

### **5. Commitments and Contingencies**

#### *MeadWestvaco Timber Agreements*

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

#### *Carbon Storage Agreement*

Wells Timberland REIT has entered into a carbon storage agreement (the *Carbon Storage Agreement*) with Carbon TreeBank LLC (*CTB*), which is an aggregator and facilitator of private timberland carbon offsets. The *Carbon Storage Agreement* provides that Wells Timberland REIT will participate in the carbon dioxide offset and mitigation program facilitated by CTB by managing up to 50,000 acres of Wells Timberland REIT's timberland for the purpose of the storage of atmospheric carbon. CTB agreed to purchase carbon dioxide offset credits until December 31, 2011, subject to demand under the program, at a price based on the average monthly strike price of carbon credits traded on the Chicago Climate Exchange for the preceding calendar year. For the three months and six months ended June 30, 2009, approximately \$85,000 and \$135,000, respectively, of revenue related to the *Carbon Storage Agreement* is included in other revenues in the accompanying consolidated statements of operations.

#### *Litigation*

Wells Timberland REIT is from time to time a party to legal proceedings that arise in the ordinary course of its business. Wells Timberland REIT is not currently involved in any legal proceedings of which the outcome is reasonably likely to have a material adverse effect on the results of operations or financial condition of Wells Timberland REIT. Wells Timberland REIT is not aware of any such legal proceedings contemplated by governmental authorities.

**Table of Contents****6. Supplemental Disclosures of Noncash Activities**

Outlined below are significant noncash investing and financing transactions for the six months ended June 30, 2009 and 2008, respectively:

	Six months ended June 30,	
	2009	2008
Other offering costs due to affiliate	\$ 380,118	\$ 570,455
Commissions on stock sales and related dealer-manager fees due to affiliate		\$ 82,965
Discounts applied to issuance of common stock	\$ 193,597	\$ 139,539
Dividends accrued on preferred stock	\$ 1,805,229	\$ 1,357,978

**7. Related-Party Transactions***Advisory Agreement*

Wells Timberland REIT and Wells Timberland OP are party to the Advisory Agreement with Wells TIMO, a wholly-owned subsidiary of Wells Capital.

Pursuant to the Advisory Agreement, Wells TIMO is entitled to the following fees and reimbursements:

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

Monthly asset management fees equal to one-twelfth of 1.0% of the greater of (i) the gross cost of all investments made on behalf of Wells Timberland REIT or (ii) the aggregate value of such investments. Wells TIMO may engage experienced timber management companies to assist Wells TIMO with certain of its asset management responsibilities under the Advisory Agreement, including investing in timberland and selling timber on behalf of Wells Timberland REIT. Any timber asset managers would perform these services under contracts with Wells TIMO and would be compensated by Wells TIMO under the terms of such contracts.

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

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





---

**Table of Contents**

the lesser of (i) 6.0% of the sales price of each property or (ii) the level of real estate commissions customarily charged in light of the size, type, and location of the property.

Effective July 11, 2009, the Advisory Agreement was renewed upon terms identical to those of the Advisory Agreement in effect through July 10, 2009. The Advisory Agreement has a one year term and will renew for successive one-year terms upon the mutual consent of the parties. Wells Timberland REIT may terminate the Advisory Agreement without penalty upon 60 days' written notice. If Wells Timberland REIT terminates the Advisory Agreement, it will pay Wells TIMO all unpaid reimbursements of expenses and all earned but unpaid fees. In addition, if the Advisory Agreement is terminated without cause, the special units of limited partnership held by Wells TIMO will be redeemed. For further information on the special units, including redemption payments, refer to the consolidated financial statements and accompanying notes included in Wells Timberland REIT's Annual Report on Form 10-K for the year ended December 31, 2008, as amended.

Under the terms of the Advisory Agreement, Wells Timberland REIT is required to reimburse Wells TIMO for certain organization and offering costs up to the lesser of actual expenses or 1.2% of gross offering proceeds raised. As of June 30, 2009, Wells Timberland REIT has incurred and charged to additional paid-in capital cumulative organization and other offering costs of approximately \$2.0 million related to the Initial Public Offering, which represents approximately 1.2% of cumulative gross proceeds raised by Wells Timberland REIT under the Initial Public Offering. As of June 30, 2009, Wells TIMO and its affiliates have incurred aggregate organization and offering expenses related to Wells Timberland REIT's Initial Public Offering and Follow-On Offering of approximately \$6.5 million and \$0.5 million, respectively. Upon the expiration of Wells Timberland REIT's Initial Public Offering on August 11, 2009, any organization and offering expenses related to the Initial Public Offering that have not been incurred and charged to additional paid-in capital by Wells Timberland REIT will be expensed by Wells TIMO and not subject to reimbursement by Wells Timberland REIT.

The mezzanine and senior loans contain restrictive covenants that prohibit Wells Timberland REIT from paying monthly asset management fees, administrative expense reimbursements, and a substantial portion of organization and offering cost reimbursements to Wells TIMO until the mezzanine loan is repaid in full and after reduction of the senior loan to a 40% loan-to-collateral value ratio. These amounts are recorded as due to affiliates in the accompanying consolidated balance sheets.

*Dealer-Manager Agreement*

Wells Timberland REIT has executed a dealer-manager agreement (the "Dealer-Manager Agreement"), whereby Wells Investment Securities, Inc. ("WIS"), an affiliate of Wells Capital, will perform the dealer-manager function for Wells Timberland REIT's Initial Public Offering. For these services, WIS earns a commission of up to 7.0% of the gross offering proceeds from the sale of Wells Timberland REIT's shares, of which substantially all is re-allowed to participating broker/dealers. Wells Timberland REIT pays no commissions on shares issued under its distribution reinvestment plan.

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

**Table of Contents***Related-Party Costs*

Pursuant to the terms of the agreements described above, Wells Timberland REIT incurred the following related-party costs for the three months and six months ended June 30, 2009 and 2008, respectively:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Commissions <sup>(1)(2)</sup>	\$ 1,114,826	\$ 1,784,912	\$ 2,046,791	\$ 3,191,115
Administrative reimbursements	115,534	700,502	732,229	1,324,882
Dealer-manager fees <sup>(1)</sup>	298,255	473,094	564,181	847,115
Asset management fees	992,407	998,993	1,990,119	2,005,790
Disposition fees	2,890		100,484	80,485
Other offering costs <sup>(1)</sup>	200,272	312,924	380,118	570,455
<b>Total</b>	<b>\$ 2,724,184</b>	<b>\$ 4,270,425</b>	<b>\$ 5,813,922</b>	<b>\$ 8,019,842</b>

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

<sup>(2)</sup> Substantially all commissions have been re-allowed to participating broker/dealers through June 30, 2009.  
*Due to Affiliates*

The detail of amounts due to affiliates is provided below as of June 30, 2009 and December 31, 2008:

	June 30, 2009	December 31, 2008
Administrative reimbursements due to Wells TIMO	\$ 6,404,857	\$ 5,672,628
Operating expense reimbursements due to Wells TIMO	1,021,309	1,021,309
Asset management fees due to Wells TIMO	6,668,128	4,678,009
Other offering cost reimbursements due to Wells TIMO	1,763,536	1,383,418
Commissions on stock sales and related dealer-manager fees due to WIS	29,038	34,842
<b>Total</b>	<b>\$ 15,886,868</b>	<b>\$ 12,790,206</b>

*Conflicts of Interest*

As of June 30, 2009, Wells TIMO had ten employees. Wells TIMO relies upon employees of Wells Capital, the parent company and manager of Wells TIMO, to perform many of its obligations. Wells Capital also is a general partner or advisor of various affiliated public real estate investment programs (Wells Real Estate Funds). As such, in connection with serving as a general partner or advisor for Wells Real Estate Funds and managing Wells TIMO's activities under the Advisory Agreement, Wells Capital may encounter conflicts of interest with regard to allocating human resources and making decisions related to investments, operations, and disposition-related activities for Wells Timberland REIT and Wells Real Estate Funds.

Additionally, one of the independent members of Wells Timberland REIT's board of directors also serves on the board of another REIT sponsored by Wells Capital and, accordingly, may encounter certain conflicts of interest regarding investment and operations decisions.



## **Table of Contents**

### *Economic Dependency*

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

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

Future net income generated by Wells REF will be largely dependent upon the amount of fees earned by Wells Capital, Wells TIMO, WIS, and Wells Management based on, among other things, the level of real estate assets managed, the amount of investor proceeds raised and the volume of future acquisitions and dispositions of real estate assets by Wells Timberland REIT and other Wells REF-sponsored investment products. As of June 30, 2009, Wells Timberland REIT believes that Wells REF generates adequate cash flow from operations and has adequate liquidity available in the form of cash on hand and other investments to meet its current and future obligations as they become due.

Wells REF guarantees the mezzanine loan held by Wells Timberland REIT, which had an outstanding principal balance of approximately \$34.7 million as of July 31, 2009 (see Note 4).

## **8. Subsequent Events**

### *Overview*

Wells Timberland REIT evaluates subsequent events in conjunction with the preparation of consolidated financial statements and notes thereto. With respect to the consolidated financial statements and related footnotes included in this report on Form 10-Q, Wells Timberland REIT has evaluated subsequent events occurring during the period from July 1, 2009 through August 7, 2009, the date of filing with the SEC.

### *Sale of Shares of Common Stock*

From July 1, 2009 through July 31, 2009, Wells Timberland REIT raised approximately \$6.3 million through the issuance of approximately 0.6 million shares of common stock under the Initial Public Offering. As of July 31, 2009, approximately 57.8 million shares remained available for sale to the public, exclusive of shares available under Wells Timberland REIT's distribution reinvestment plan. As noted above, on April 8, 2009, Wells Timberland REIT entered into the Amended Master Purchase Agreement in connection with the German Offering. No proceeds were raised from the issuance of common stock under the German Offering from July 1, 2009 through July 31, 2009. As of July 31, 2009, approximately 53.8 million shares remained available for sale to the Funds under the German Offering.

**Table of Contents**

*Senior Loan Consent*

On July 23, 2009, Wells Timberland REIT entered into a consent to the senior loan agreement with CoBank regarding the application of proceeds generated from the disposition of up to 15,000 acres of the Mahrt Timberland in one or more sale transactions that are expected to occur between the July 23, 2009 and March 31, 2010. Upon closing, proceeds generated from the disposition of the timberland will be applied as follows: (i) a consent fee equal to 0.40% of the outstanding senior loan will be paid to CoBank; (ii) if necessary, the working capital account will be funded to a total balance of \$3.0 million; (iii) 70% of the remaining proceeds will be applied to the prepayment of the senior loan; and (iv) the remaining proceeds shall be applied to the prepayment of the mezzanine loan. As an inducement to CoBank to enter into the consent, Wells Timberland REIT paid a fee equal to 0.15% of the balance of the senior loan outstanding on July 31, 2009, or approximately \$0.3 million.

---

**Table of Contents**

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

The following discussion and analysis should be read in conjunction with our accompanying consolidated financial statements and notes thereto. See also Cautionary Note Regarding Forward-Looking Statements preceding Part I, as well as our consolidated financial statements and the notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended December 31, 2008, as amended.

**Overview**

We were formed on September 27, 2005 to acquire and operate a diversified portfolio of timberland properties located in the timber-producing regions of the United States and, to a limited extent, in other countries. We generate a substantial majority of our revenue and income by selling the rights to access land and harvest timber to third parties pursuant to supply agreements and through open-market sales, from selling HBU timberland and leasing land-use rights to third parties. We also generate additional revenues and income from selling the rights to extract natural resources from timberland other than timber. A substantial portion of our timber sales are derived from the Timber Agreements under which we sell to MeadWestvaco specified amounts of timber subject to market pricing adjustments. The initial term of the Timber Agreements is from October 9, 2007 through December 31, 2032, subject to extension and early termination provisions. We have no paid employees and are externally advised and managed by Wells TIMO, a wholly owned subsidiary of Wells Capital.

We began receiving investor proceeds from the sale of our common stock under our Initial Public Offering in May 2007. On July 11, 2007, we raised our minimum offering of \$2.0 million, and thus commenced operations. We began acquiring timber assets in October 2007 and our German Offering commenced in July 2008. We continued receiving investor proceeds under our Initial Public Offering and our German Offering (the Offerings) through June 30, 2009. Thus, the results of our operations for the three months and six months ended June 30, 2009 and 2008 are indicative of an early-stage enterprise with growing revenues and expenses associated with the acquisition of timber assets, interest expense associated with debt financing on the acquisition of timber assets, and general and administrative expenses that represent a high percentage of total revenues but are expected to decrease as the enterprise grows. As of June 30, 2009, we have raised gross offering proceeds of approximately \$165.4 million through the issuance of our common stock in our Initial Public Offering and approximately \$42.8 million through the issuance of our preferred stock to Wells REF.

Our most significant risks and challenges include our ability to raise a sufficient amount of equity that will allow us to repay the loans associated with the Mahrt Timberland acquisition and to further diversify our portfolio of timber assets. To the extent that significant funds are not raised, we may not be able to repay the loans or achieve sufficient diversification to guard against the general economic, industry-specific, financing, and operational risks generally associated with individual investments.

**Liquidity and Capital Resources**

*Overview*

We began to sell shares of our common stock to the public under our Initial Public Offering in May 2007 and to the Funds under our German Offering in July 2008. During the six months ended June 30, 2009, we raised proceeds under our Initial Public Offering, net of commissions, dealer-manager fees, other offering costs, and redemptions, of approximately \$28.6 million, substantially all of which was used to pay down debt associated with the acquisition of the Mahrt Timberland in October 2007. The majority of the purchase price for the Mahrt Timberland was indirectly financed through third-party borrowings consisting of a first mortgage loan of \$212.0 million with CoBank, ACB (CoBank) serving as lead lender and administrative

---

**Table of Contents**

agent (the Senior Loan ) and a second mortgage loan, as amended, for \$160.0 million with Wachovia Bank, N.A. ( Wachovia ) serving as lead lender and administrative agent (the Mezzanine Loan ). The remaining purchase price for the Mahrt Timberland was financed through the issuance of approximately \$32.1 million of preferred stock to Wells REF.

All of the proceeds raised under our Offerings, net of fees, expenses, and redemptions of our common stock due to death and qualifying disability, are required to be used to service the Mezzanine Loan, which currently incurs interest at a rate of 11.0% and matures on April 30, 2010. We are required to make principal reduction payments on the Mezzanine Loan on September 30, 2009 and December 31, 2009, reducing the outstanding principal balance to an amount not greater than \$30.0 million and \$15.0 million, respectively. On April 30, 2010, all outstanding principal, interest, and any fees or other obligations on the Mezzanine Loan will be due and payable in full. As of July 31, 2009, the outstanding principal balance on the Mezzanine Loan was approximately \$34.7 million. Net cash flows generated from our operations, including proceeds received from the sale of timber and timberland less a working capital reserve, are required to be used to service the Senior Loan, which matures on September 9, 2010. Once the Mezzanine Loan is repaid in full, future proceeds raised under our Offerings, net of fees, expenses, and redemptions of common stock, are required to be used to repay the Senior Loan until achieving a 40% loan-to-collateral value ratio.

The Senior Loan and Mezzanine Loan contain restrictive covenants that prohibit us from declaring, setting aside funds for, or paying any dividend, distribution, or other payment to our stockholders while the Senior Loan and Mezzanine Loan are outstanding. As a result, we will be unable to make any payments or distributions to our stockholders until the Mezzanine Loan is repaid in full and after reduction of the Senior Loan to a 40% loan-to-collateral value ratio. Once the Mezzanine Loan has been repaid in full and the Senior Loan reduced to a loan-to-collateral value ratio of 40%, future proceeds raised from the sale of our shares under our Offerings will be deemed available for investment in timberland and related assets, and future operating cash flows will be deemed available for distribution to stockholders. In addition to those restrictive covenants discussed above, the Senior Loan and Mezzanine Loan require us to maintain a minimum debt service coverage ratio, as defined by the credit agreement, of 1.60:1.00 during 2009; and 1.70:1.00 through their respective maturity dates.

We anticipate that our primary sources of future capital will be derived from the sale of our common stock under our Offerings and from operations through the sale of timberland and rights to access our land and harvest our timber to MeadWestvaco and other third parties. Following the settlement of the Mezzanine Loan and reduction of the Senior Loan to a 40% loan-to-collateral value ratio, the amount of cash available for distribution to stockholders and the level of distributions declared will depend primarily upon the amount of cash generated from our operating activities, our determination of funding needs for near-term capital and other debt service requirements, and our expectations of future cash flows.

*Short-Term Liquidity and Capital Resources*

Net cash used in financing activities for the six months ended June 30, 2009 was approximately \$3.0 million. During the six months ended June 30, 2009, we raised proceeds from the sale of common stock under our Offerings, net of commissions, dealer-manager fees, and redemptions, of approximately \$29.0 million, which was used to pay down the Mezzanine Loan by approximately \$25.7 million and to fund interest expense on the Mezzanine Loan. For the six months ended June 30, 2009, we generated net proceeds from the sale of timberland of approximately \$4.8 million, approximately \$3.8 million of which was used to pay down the Senior Loan and approximately \$1.0 million of which was used to fund a working capital reserve. Net cash provided by operating activities for the six months ended June 30, 2009 was approximately \$4.6 million, which is primarily comprised of receipts from timber and timberland sales, and rental income from recreational leases in excess of operating costs, interest expense, asset and forestry management fees, and general and administrative expenses. During the six months ended June 30, 2009, net cash used in investing activities was approximately \$0.9 million, which included approximately \$0.2 million of net funds invested in escrow accounts required by lenders and approximately \$0.7 million invested in timber, timberland, and



## **Table of Contents**

related assets. We expect to utilize the residual cash balance of approximately \$4.9 million as of June 30, 2009 to satisfy current liabilities.

### *Long-Term Liquidity and Capital Resources*

Over the long-term, we expect our primary sources of capital to include proceeds from the sale of our common stock, proceeds from secured or unsecured financings from banks and other lenders, and net cash flows from operations. We expect our principal demands for capital to include funding future acquisitions of timberland, either directly or through investments in joint ventures; capital improvements for such timberland; offering-related costs; operating expenses, including interest expense on any outstanding indebtedness; and distributions.

On February 3, 2009, we filed a registration statement, as amended on June 19, 2009 and August 5, 2009, with the SEC to register 220.9 million shares of common stock, of which 200.0 million shares are to be offered in a primary offering for \$10.00 per share and 20.9 million shares of common stock are to be offered under our distribution reinvestment plan for \$9.55 per share (the Follow-On Offering). On August 6, 2009, Wells Timberland REIT's Follow-On Offering was declared effective by the SEC and Wells Timberland REIT commenced offering activities for the Follow-On Offering promptly thereafter. Wells Timberland REIT expects to stop offering shares for sale under the Initial Public Offering on August 11, 2009 and begin accepting subscriptions under the Follow-On Offering on August 12, 2009.

In determining how and when to allocate cash resources in the future, we will initially consider the source of the cash. Once the Mezzanine Loan is repaid in full and after reduction of the Senior Loan to a 40% loan-to-collateral value ratio, we anticipate using cash generated from operations, after payments of periodic operating expenses, interest expense and certain capital expenditures required for our timberland, to repay amounts due to affiliates and pay distributions to stockholders. Therefore, to the extent that cash flows from operations are lower, distributions are anticipated to be lower as well. However, in addition to net cash flows from operations, we may periodically borrow funds on a short-term basis to fund distributions. Once the Mezzanine Loan is repaid in full and after reduction of the Senior Loan to a 40% loan-to-collateral value ratio, we anticipate using substantially all net proceeds raised from the sale of our shares under our Offerings to fund future acquisitions of timberland, to fund capital expenditures, and to pay down the remaining Senior Loan and/or future borrowings. Proceeds generated from future debt financings may also be used to fund future acquisitions of timberland and capital expenditures.

If sufficient equity or debt capital is not available, our future investments in timberland will be lower. Our charter precludes us from incurring debt in excess of 300% of our net assets, which we generally expect to approximate 75% of our timber assets before adjustment for noncash reserves, depletion, and amortization; however, we may temporarily exceed this limit upon the approval of a majority of our independent directors. As of June 30, 2009, our leverage ratio was approximately 59% and our debt-to-net assets ratio was approximately 168%. Our board of directors may determine that it is in our best interest to pursue highly leveraged timberland acquisitions in order to enable us to more quickly acquire a diversified portfolio of timberland properties. As a result, we are not able to anticipate with any degree of certainty what our leverage ratio will be in the near future. However, over the long-term, we expect our leverage ratio to be no more than 50%. In accordance with our charter, if our board of directors, including a majority of our independent directors, approves any borrowing in excess of our leverage limitation, we will disclose such approval to our stockholders in our next quarterly report, along with an explanation for such excess.

### *Contractual Obligations and Commitments*

We are subject to certain commitments and contingencies with regard to certain transactions. Refer to Note 5 and Note 7 of our accompanying consolidated financial statements for further explanations. All of the proceeds raised under our Offerings, net of fees, expenses and redemptions of our common stock for death and qualifying disability, are required to be used to service the Mezzanine Loan, which currently incurs

**Table of Contents**

interest at a rate of 11.0%. See Liquidity and Capital Resources. Once the Mezzanine Loan is repaid in full, future proceeds raised under our Offerings, net of fees and expenses, are required to be used to service the Senior Loan until achieving a 40% loan-to-collateral value ratio.

Our contractual obligations as of June 30, 2009 will become payable in the following periods:

Contractual Obligations	Total	Payments Due by Period			
		2009	2010-2011	2012-2013	Thereafter
Outstanding debt obligations	\$ 242,391,056	\$ 24,994,110	\$ 217,396,946	\$	\$
Estimated interest on debt obligations <sup>(1)</sup>	13,273,303	6,648,738	6,624,565		
Operating lease obligations	19,282,847	1,391,669	3,906,881	3,216,721	10,767,576
Due to affiliates <sup>(2)</sup>	16,546,868		16,546,868		
<b>Total</b>	<b>\$ 291,494,074</b>	<b>\$ 33,034,517</b>	<b>\$ 244,475,260</b>	<b>\$ 3,216,721</b>	<b>\$ 10,767,576</b>

<sup>(1)</sup> Amounts include impact of interest rate swaps. See *Item 3. Quantitative and Qualitative Disclosure About Market Risk* for more information regarding our interest rate swaps

<sup>(2)</sup> The Mezzanine Loan and Senior Loan contain restrictive covenants that prohibit Wells Timberland REIT from paying monthly asset management fees, administrative expense reimbursements, and a substantial portion of organization and offering cost reimbursements to Wells TIMO until the Mezzanine Loan is repaid in full and after reduction of the Senior Loan to a 40% loan-to-collateral value ratio, which we expect to occur in 2010.

**Results of Operations***Overview*

Our results of operations are materially impacted by the fluctuating nature of timber prices, changes in the levels and composition of our harvest volumes, changes to associated depletion rates, and varying interest expense based on the amount and cost of outstanding borrowings. In the second quarter of 2009, average prices for sawtimber and chip-n-saw on a stumpage basis were approximately 17% lower than the second quarter of 2008, primarily due to weak lumber and plywood markets resulting from the significant decline in new residential construction. Pulpwood prices were 3% higher in the second quarter of 2009 as compared to the second quarter of 2008 due to a shortage of wood chips as a result of curtailed lumber production. For the three months ended June 30, 2009, our harvest volumes increased compared to the three months ended June 30, 2008. Contract logging and hauling rates for the three months ended June 30, 2009 was 1% lower compared to the three months ended June 30, 2008, primarily due to lower fuel costs. Prior to January 1, 2009, depletion rates for our fee-simple tracts were determined by dividing the acquisition costs attributable to its timber by the volume of timber acquired. On January 1, 2009, depletion rates for our fee-simple timber tracts owned for longer than one year were adjusted for silviculture costs incurred and expected to be incurred and for the total timber volume estimated to be available over the harvest cycle. These adjustments resulted in lower depletion rates for our fee-simple tracts owned for longer than one year compared to 2008. In the second quarter of 2009, our weighted-average outstanding borrowings were approximately \$479.5 million lower compared to the second quarter 2008, primarily due to the disposition of an approximately \$398.0 million promissory note in connection with the disposition of a wholly owned subsidiary on December 18, 2008. For more information on this disposition, see Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended December 31, 2008, as amended.

---

**Table of Contents**

*Comparison of the three months ended June 30, 2008 versus the three months ended June 30, 2009*

*Revenues.* Revenues increased from approximately \$10.6 million for the three months ended June 30, 2008 to approximately \$12.3 million for the three months ended June 30, 2009 due to increases in timber sales, timberland sales, and other revenues of approximately \$1.3 million, \$0.1 million, and \$0.2 million, respectively. Revenue from timber sales increased due to an increase in harvest volume, offset by lower sawtimber and chip-n-saw prices. Revenue from timberland sales increased as a result of selling approximately 50 acres during the three months ended June 30, 2009. Other revenues increased primarily due to increases in recreational lease rates and a receipt of \$85,000 associated with the Carbon Storage Agreement that was entered into in March 2009. Future revenues from timber sales related to the Mahrt Timberland are expected to remain relatively stable based on slight increases in harvest volumes and stable pulpwood prices, offset by lower chip-n-saw and sawtimber prices.

*Operating expenses.* Contract logging and hauling costs increased from approximately \$5.0 million for the three months ended June 30, 2008 to approximately \$5.5 million for the three months ended June 30, 2009 due to an approximately 12% increase in delivered wood volume, partially offset by lower logging rates. Depletion decreased from approximately \$5.0 million for the second quarter of 2008 to approximately \$4.5 million for the same period in 2009 due to lower depletion rates on our fee-simple tracts compared to 2008. Cost of timberland sales increased as a result of selling approximately 50 acres during the quarter. Other forestry management fees decreased from approximately \$0.9 million for the three months ended June 30, 2008 to approximately \$0.8 million for the three months ended June 30, 2009, primarily due to a decrease in the number of acres under management. Land rent expense decreased from approximately \$637,000 for the three months ended June 30, 2008 to approximately \$568,000 for the three months ended June 30, 2009 due to the expiration of leases covering approximately 4,900 acres. Other operating costs decreased from approximately \$1.3 million for the three months ended June 30, 2008 to approximately \$0.7 million for the three months ended June 30, 2009 due to a decrease in property taxes accrued in the second quarter of 2009 as compared to 2008.

Contract logging and hauling, depletion, and other operating expenses are expected to remain relatively stable in future periods prior to the acquisition of additional timber assets. Asset and forestry management fees, which are primarily based on the number of acres managed, are expected to remain relatively stable due to no significant changes in the number of acres owned during the year.

*General and administrative expenses.* General and administrative expenses decreased from approximately \$1.2 million for the three months ended June 30, 2008 to approximately \$0.9 million for the three months ended June 30, 2009 primarily due to an approximately \$0.7 million decrease in salary expense, offset by increases in certain professional fees, including audit, tax and legal fees. General and administrative expenses are expected to remain relatively stable in future periods prior to the acquisition of additional timber assets.

*Interest income.* Interest income decreased from approximately \$2.9 million for the three months ended June 30, 2008 to approximately \$7,000 for the three months ended June 30, 2009, primarily as a result of the disposition of an approximately \$398.0 million certificate of deposit in December 2008. Future levels of interest income will vary, primarily due to changes in amounts required to be escrowed by our lenders and changes in market interest rates during future periods.

*Interest expense.* Interest expense decreased from approximately \$10.8 million for the three months ended June 30, 2008 to approximately \$2.8 million for the three months ended June 30, 2009, primarily due to the disposition of an approximately \$398.0 million promissory note in December 2008, lower principal balances outstanding on our debt facilities, and an approximately \$1.8 million reduction in amortization of deferred financing costs. Interest expense, as compared to prior periods, is expected to continue to decrease; however, actual interest expense in future periods will vary based on our level of current and future borrowings, which will depend on the level of equity proceeds raised, the cost of future borrowings, and the opportunity to acquire timber assets fitting our investment objectives.

---

**Table of Contents**

*Interest rate risk instruments.* We recognized a loss on our interest rate swaps that do not qualify for hedge accounting treatment of approximately \$0.4 million for the three months ended June 30, 2009 compared to a gain of approximately \$2.9 million for the three months ended June 30, 2008. The loss was primarily due to the fact that the variable interest rate incurred on our Senior Loan was lower than the contractual interest rates of the related interest rate swaps during the three months ended June 30, 2009. We expect that future gains and losses on our interest rate swaps that do not qualify for hedge accounting treatment will fluctuate primarily as a result of additional changes in market interest rates and changes in the economic outlook for future market rates.

*Net loss.* Our net loss decreased from approximately \$9.4 million for the three months ended June 30, 2008 to approximately \$4.8 million for the three months ended June 30, 2009, primarily as a result of a decrease in interest expense, net of interest income, of approximately \$5.2 million. We sustained a net loss for the three months ended June 30, 2009 primarily as a result of incurring interest expense, net of interest income, of \$2.7 million in connection with borrowings used to finance the purchase of the Mahrt Timberland and continued decreases in timber prices. We opted to leverage the Mahrt Timberland acquisition with substantial short-term and medium-term borrowings as a result of sourcing this acquisition in advance of raising investor proceeds under our Initial Public Offering. Our net loss per share available to common stockholders for the three months ended June 30, 2009 and 2008 was \$0.36 and \$1.32, respectively. As we continue to raise equity under our Offerings to repay the Mezzanine Loan and the Senior Loan, we anticipate additional decreases in interest expense, which is expected to reduce future net losses.

*Comparison of the six months ended June 30, 2008 versus the six months ended June 30, 2009*

*Revenues.* Revenues increased from approximately \$25.9 million for the six months ended June 30, 2008 to approximately \$27.7 million for the six months ended June 30, 2009 due to increases in timber sales, timberland sales, and other revenues of approximately \$0.5 million, \$1.0 million, and \$0.3 million, respectively. The increase in revenue from timber sales was primarily due to an increase in non-delivered timber sales volume, offset by lower sawtimber and chip-n-saw prices. Revenue from timberland sales increased as a result of selling approximately 3,000 acres during the six months ended June 30, 2009 as compared to selling 1,600 acres during the same period in 2008. Other revenue increased primarily due to a receipt of approximately \$135,000 associated with the Carbon Storage Agreement that was entered into in March 2009 and increases in recreational lease rates. Future revenue from timber sales related to the Mahrt Timberland is expected to remain relatively stable based on slight increases in harvest volumes and stable pulpwood prices, offset by lower chip-n-saw and sawtimber prices.

*Operating expenses.* Contract logging and hauling costs for the six months ended June 30, 2008 and 2009 were comparable due to relatively stable volumes of delivered timber. Depletion decreased from approximately \$10.5 million for the six months ended June 30, 2008 to approximately \$8.7 million for the same period in 2009 due to lower depletion rates on our fee-simple tracts compared to 2008. Cost of timberland sales increased from approximately \$2.6 million for the six months ended June 30, 2008 to approximately \$3.4 million for the six months ended June 30, 2009, primarily as a result of selling approximately 1,410 more acres in the first six months of 2009. Other operating costs decreased from approximately \$1.6 million for the six months ended June 30, 2008 to approximately \$1.3 million for the six months ended June 30, 2009 primarily due to a decrease in property tax expense resulting from fewer acres owned and lower property tax rates.

Contract logging and hauling, depletion, and other operating expenses are expected to remain relatively stable in future periods prior to the acquisition of additional timber assets. Asset and forestry management fees, which are primarily based on the number of acres managed, are expected to remain relatively stable due to no significant changes in the number of acres owned during the year.

*General and administrative expenses.* General and administrative expenses decreased from approximately \$2.3 million for the six months ended June 30, 2008 to approximately \$1.9 million for the six months ended June 30, 2009 primarily due to an approximately \$0.7 million decrease in salary expense, offset by increases

---

## **Table of Contents**

in certain professional fees, including audit, tax and legal fees. General and administrative expenses are expected to be relatively stable in future periods prior to the acquisition of additional timber assets.

*Interest income.* Interest income decreased from approximately \$7.8 million for the six months ended June 30, 2008 to approximately \$25,000 for the six months ended June 30, 2009, primarily as a result of the disposition of an approximately \$398.0 million certificate of deposit in December 2008. Future levels of interest income will vary, primarily due to changes in amounts required to be escrowed by our lenders and changes in market interest rates during future periods.

*Interest expense.* Interest expense decreased from approximately \$23.9 million for the six months ended June 30, 2008 to approximately \$5.8 million for the six months ended June 30, 2009, primarily due to the disposition of an approximately \$398.0 million promissory note in December 2008, lower principal balances outstanding on our debt facilities, and an approximately \$3.4 million reduction in amortization of deferred financing costs. Interest expense, as compared to prior periods, is expected to continue to decrease; however, actual interest expense in future periods will vary based on our level of current and future borrowings, which will depend on the level of equity proceeds raised, the cost of future borrowings, and the opportunity to acquire timber assets fitting our investment objectives.

*Interest rate risk instruments.* We recognized a loss on our interest rate swaps that do not qualify for hedge accounting treatment of approximately \$1.3 million for the six months ended June 30, 2009 compared to a loss of approximately \$2.2 million for the six months ended June 30, 2008. The loss was primarily due to the fact that the variable interest rate incurred on our Senior Loan was lower than the contractual interest rates of the related interest rate swaps during the six months ended June 30, 2009. The decrease in the loss was primarily due to decreases in the nominal amounts and lengths of time remaining under the respective swap contracts, changes in market interest rates and changes in the outlook of future market interest rates. We expect that future gains and losses on our interest rate swaps that do not qualify for hedge accounting treatment will fluctuate primarily as a result of additional changes in market interest rates and changes in the economic outlook for future market rates.

*Net loss.* Our net loss decreased from approximately \$24.2 million for the six months ended June 30, 2008 to approximately \$9.4 million for the six months ended June 30, 2009, primarily as a result of an increase in revenues of approximately \$1.9 million and decreases in interest expense, net of interest income, depletion, and loss on interest rate swaps of approximately \$10.3 million, \$1.9 million and \$0.9 million, respectively. We sustained a net loss for the six months ended June 30, 2009 primarily as a result of incurring interest expense, net of interest income, of \$5.8 million in connection with borrowings used to finance the purchase of the Mahrt Timberland, incurring a loss on interest rate swaps of approximately \$1.3 million related to our hedging of interest rate risk, and continued decreases in timber prices. We opted to leverage the Mahrt Timberland acquisition with substantial short-term and medium-term borrowings as a result of sourcing this acquisition in advance of raising investor proceeds under our Initial Public Offering. Our net loss per share available to common stockholders for the six months ended June 30, 2009 and 2008 was \$0.75 and \$3.95, respectively. As we continue to raise equity under our Offerings to repay the Mezzanine Loan and the Senior Loan, we anticipate additional decreases in interest expense, which is expected to reduce future net losses.

## **Adjusted EBITDA**

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

**Table of Contents**

to be an important measure of our financial condition and cash-generating ability due to the significant amount of fixed assets subject to depletion and the significant amount of financing subject to interest and amortization expense. Our credit agreements contain a minimum debt service coverage ratio based, in part, on Adjusted EBITDA since the measure is representative of adjusted income available for interest payments.

For the three months ended June 30, 2009, Adjusted EBITDA was approximately \$2.9 million, an increase of approximately \$2.2 million from the three months ended June 30, 2008 primarily due to increased revenue from timber sales. For the six months ended June 30, 2009, Adjusted EBITDA was approximately \$9.7 million, an approximately \$2.5 million increase over the six months ended June 30, 2008 primarily due to higher revenues from timberland sales. Wells Timberland REIT's reconciliation of net loss to Adjusted EBITDA for the three months and six months ended June 30, 2009 and 2008 follows:

	For the Three Months Ended		For the Six Months Ended	
	June 30,		June 30,	
	2009	2008	2009	2008
Net loss	\$ (4,825,706)	\$ (9,417,019)	\$ (9,369,982)	\$ (24,201,692)
Add:				
Unrealized (gain) loss on interest rate swaps that do not qualify for hedge accounting treatment	(964,796)	(4,006,602)	(1,299,767)	365,252
Interest expense <sup>(1), (2)</sup>	3,705,073	6,892,275	7,666,902	13,927,054
Depletion	4,525,655	5,022,884	8,653,024	10,512,082
Amortization <sup>(1)</sup>	362,441	2,135,752	806,131	4,271,515
Basis of timberland sold	49,862		3,228,363	2,341,100
Adjusted EBITDA	\$ 2,852,529	\$ 627,290	\$ 9,684,671	\$ 7,215,311

(1) For the purpose of the above reconciliation, amortization includes amortization of deferred financing costs, amortization of intangible lease assets, and amortization of mainline road costs, which are included in either interest expense, land rent expense, or other operating expenses in the accompanying consolidated statements of operations

(2) Amount for the three months and six months ended June 30, 2008 excludes interest expense of approximately \$2.9 million and \$7.5 million, respectively, incurred on a promissory note, as amount is entirely offset by interest income earned on a certificate of deposit.

**Election as a REIT**

Pursuant to our charter, our board of directors has the authority to determine when and if it is in our best interest to elect to qualify for federal income tax treatment as a REIT. Due to our acquisition of the Mahr Timberland on October 9, 2007 and restrictions imposed by the Senior Loan and Mezzanine Loan, we determined that it was not in our best interest to be taxed as a REIT for the year ended December 31, 2008. We expect that our board of directors will elect for us to qualify as a REIT for the taxable year ended December 31, 2009. To qualify as a REIT, we must meet certain organizational and operational requirements, including a requirement to distribute at least 90% of the REIT's ordinary taxable income to stockholders. If we qualify as a REIT for federal income tax purposes, we generally will not be subject to federal income tax on taxable income that we distribute to our stockholders. If we subsequently fail to qualify as a REIT in any taxable year, we will then be subject to federal income taxes on our taxable income at regular corporate rates and will not be permitted to qualify for treatment as a REIT for federal income tax purposes for four years following the year during which qualification is lost unless the IRS grants us relief under certain statutory provisions. Such an event could materially adversely affect our net income and net cash available for distribution to stockholders. However, we believe that we are organized and operate in such a manner as to qualify for treatment as a REIT for federal income tax purposes, upon a determination by our board of directors that election of REIT status is in our best interests of our stockholders.

---

## **Table of Contents**

### **Inflation**

In connection with the acquisition of the Mahrt Timberland, we entered into the Timber Agreements with MeadWestvaco. The Timber Agreements provide that we will sell to MeadWestvaco specified amounts of timber subject to bi-annual market pricing adjustments and monthly fuel pricing adjustments, which are intended to protect us from, and mitigate the risk of, the impact of inflation. The price of timber has generally increased with increases in inflation. Because of our limited operating history, we have not noticed a significant impact from inflation or changing prices on our net sales or revenues, nor on income from continuing operations.

### **Application of Critical Accounting Policies**

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

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

#### *Timber, Timberlands, and Depletion*

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

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

We continually monitor events and changes in circumstances that could indicate that the carrying amounts of our timber assets may not be recoverable. When indicators of potential impairment are present that suggest that the carrying amounts of timber assets may not be recoverable, we assess the recoverability of these

---

## **Table of Contents**

assets by determining whether the carrying value will be recovered through the undiscounted future operating cash flows expected from the use of the asset and its eventual disposition. Impairment losses would be recognized for (i) long-lived assets used in our operations when the carrying value of such assets exceeds the undiscounted cash flows estimated to be generated from the future operations of those assets, and (ii) long-lived assets held for sale when the carrying value of such assets exceeds an amount equal to their fair value less selling costs. Estimated fair values are calculated based on the following information in order of preference, dependent upon availability: (i) recently quoted market prices, (ii) market prices for comparable properties, or (iii) the present value of undiscounted cash flows, including estimated salvage value. We intend to use one harvest cycle for the purpose of evaluating the recoverability of timber and timberlands used in our operations. Future cash flow estimates are based on probability-weighted projections for a range of possible outcomes and are discounted at the risk-free rates of interest. We consider assets to be held for sale at the point at which a sale contract is executed and the buyer has made a nonrefundable earnest money deposit against the contracted purchase price. We have determined that there has been no impairment of our long-lived assets to date.

### *Allocation of Purchase Price of Acquired Assets*

Upon the acquisition of timberland properties, we allocate the purchase price to tangible assets, consisting of timberland and timber; and identified intangible assets and liabilities, which may include values associated with in-place leases or supply agreements, based in each case on our estimate of their fair values.

The fair values of timberland and timber are determined based on available market information and estimated cash flow projections that utilize appropriate discount factors and capitalization rates. Estimates of future cash flows are based on a number of factors including the historical operating results, known and anticipated trends, and market and economic conditions. The values are then allocated to timberland and timber based on our determination of the relative fair value of these assets.

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

### *Revenue Recognition*

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

- (1) For delivered sales contracts, which include amounts billed for logging and hauling of timber, revenues are recognized upon delivery to the customer.
- (2) For pay-as-cut contracts, the purchaser acquires the right to harvest specified timber on a tract, at an agreed-upon price per unit. Payments and contract advances are recognized as revenue as the timber is harvested based on the contracted sale rate per unit.
- (3) For lump-sum sale contracts, the purchaser generally pays the purchase price upon execution of the contract. Title to the timber and risk of loss transfers to the buyer at the time the contract is consummated. Revenues are recognized upon receipt of the purchase price. When the contract expires, ownership of the remaining standing timber reverts to us; however, adjustments are not



---

**Table of Contents**

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

- (4) Revenues from the sale of HBU timberland and non-strategic timberlands are recognized when title passes and full payment or a minimum down payment is received and full collectibility is assured. If a down payment of less than the minimum down payment is received at closing, we will record revenue based on the installment method or other acceptable method.

**Related Party Transactions and Agreements**

We have engaged Wells TIMO and its affiliates to perform certain services under agreements which require us to pay fees and reimbursements to Wells TIMO or its affiliates, including asset management and disposition fees, selling commissions and dealer-manager fees, as well as subject to certain limitations, reimbursements of organization and offering costs, and certain operating costs. See Note 7 to our accompanying consolidated financial statements for a detailed discussion of our related-party agreements and the related transactions, fees and reimbursements.

*Assertions of Legal Actions against Related Parties*

On March 12, 2007, a stockholder of Piedmont Office Realty Trust, Inc., formerly known as Wells Real Estate Investment Trust, Inc. (referenced herein as Piedmont REIT ) filed a putative class action and derivative complaint, presently styled *In re Wells Real Estate Investment Trust, Inc. Securities Litigation*, in the United States District Court for the District of Maryland against, among others, Piedmont REIT; Leo F. Wells, III, our President; Wells Capital, Inc. ( Wells Capital ), the owner of our advisor; Wells Management; certain affiliates of Wells REF; the directors of Piedmont REIT; and certain individuals who formerly served as officers or directors of Piedmont REIT prior to the closing of an internalization transaction by Piedmont REIT on April 16, 2007. The complaint alleges, among other things, violations of the federal proxy rules and breaches of fiduciary duty arising from the Piedmont REIT internalization transaction and the related proxy statement filed with the SEC on February 26, 2007, as amended. The complaint seeks, among other things, unspecified monetary damages and nullification of the Piedmont REIT internalization transaction. On April 9, 2007, the District Court denied the plaintiff's motion for an order enjoining the internalization transaction. On April 17, 2007, the court granted the defendants' motion to transfer venue to the United States District Court for the Northern District of Georgia, and the case was docketed in the Northern District of Georgia on April 24, 2007. On June 7, 2007, the Court granted a motion to designate the class lead plaintiff and class co-lead counsel. On June 27, 2007, the plaintiff filed an amended complaint, which attempts to assert class action claims on behalf of those persons who received and were entitled to vote on the Piedmont REIT proxy statement filed with the SEC on February 26, 2007, and derivative claims on behalf of Piedmont REIT. On July 9, 2007, the court denied the plaintiff's motion for expedited discovery related to an anticipated motion for a preliminary injunction. On August 13, 2007, the defendants filed a motion to dismiss the amended complaint. On March 31, 2008, the court granted in part the defendants' motion to dismiss the amended complaint. The court dismissed five of the seven counts of the amended complaint in their entirety. The court dismissed the remaining two counts with the exception of allegations regarding the failure to disclose in the Piedmont REIT proxy statement details of certain expressions of interest in acquiring Piedmont REIT. On April 21, 2008, the plaintiff filed a second amended complaint, which alleges violations of the federal proxy rules based upon allegations that the proxy statement to obtain approval for the Piedmont REIT internalization transaction omitted details of certain expressions of interest in acquiring Piedmont REIT. The second amended complaint seeks, among other things, unspecified monetary damages, to nullify and rescind the internalization transaction, and to cancel and rescind any stock issued to the defendants as consideration for the internalization transaction. On May 12, 2008, the defendants answered and raised certain defenses to the second amended complaint. On June 23, 2008, the plaintiff filed a motion for class certification. The defendants responded to the plaintiff's motion for class certification on January 16, 2009. The plaintiff filed its reply in support of its motions for class certification on February 19, 2009. The motion for class certification is currently pending before the court. The parties are presently engaged in discovery. On April 13, 2009, the plaintiff moved for leave to amend the second amended

## **Table of Contents**

complaint to add additional defendants. The defendants responded to the plaintiff's motion for leave to amend on April 30, 2009. The plaintiff filed its reply in support of its motion for leave to amend on May 18, 2009. The court denied the motion for leave to amend on June 23, 2009. Mr. Wells, Wells Capital, and Wells Management intend to vigorously defend this action. Any financial loss incurred by Wells Capital or its affiliates, including our advisor, could hinder our advisor's ability to successfully manage our operations and our portfolio of investments.

## **Commitments and Contingencies**

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

MeadWestvaco Timber Agreements;

Carbon Storage Agreement;

Advisory Agreement; and

Dealer-Manager Agreement.

## **Subsequent Events**

### *Sale of Shares of Common Stock*

From July 1, 2009 through July 31, 2009, we raised approximately \$6.3 million through the issuance of approximately 0.6 million shares of our common stock under our Initial Public Offering. As of July 31, 2009, approximately 57.8 million shares remained available for sale to the public under our Initial Public Offering, exclusive of shares available under our distribution reinvestment plan. On April 8, 2009, we entered into the Amended Master Purchase Agreement in connection with the German Offering. No proceeds were received from issuance of common stock under the German Offering from July 1, 2009 through July 31, 2009. As of July 31, 2009, approximately 53.8 million shares remained available for sale to the Funds under our German Offering.

### *Senior Loan Consent*

On July 23, 2009, we entered into a consent to the Senior Loan agreement with CoBank regarding the application of proceeds generated from the disposition of up to 15,000 acres of the Mahrt Timberland in one or more sale transactions that are expected to occur between the July 23, 2009 and March 31, 2010. Upon closing, proceeds generated from the disposition of the timberland will be applied as follows: (i) a consent fee equal to 0.40% of the outstanding Senior Loan will be paid to CoBank; (ii) if necessary, the working capital account will be funded to a total balance of \$3.0 million; (iii) 70% of the remaining proceeds will be applied to the prepayment of the Senior Loan; and (iv) the remaining proceeds shall be applied to the prepayment of the Mezzanine Loan. As an inducement to CoBank to enter into the consent, we paid a fee equal to 0.15% of the balance of the senior loan outstanding on July 31, 2009, or approximately \$0.3 million.

---

**Table of Contents****ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

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

Our financial instruments consist of both fixed- and variable-rate debt. As of June 30, 2009, we had approximately \$202.4 million outstanding on the Senior Loan and approximately \$40.0 million outstanding on the Mezzanine Loan. After consideration of interest rate swaps described below, only approximately \$21.4 million of the Senior Loan bears interest at an effectively variable rate. As of June 30, 2009, the weighted-average interest rate of our fixed- and variable-rate debt was 5.59%.

The Senior Loan matures on September 9, 2010 ( Senior Loan Maturity Date ) and bears interest at one-, two-, or three-month LIBOR plus a margin that varies based upon the ratio of the amount of the Senior Loan to the value of the Mahrt Timberland at the time of determination. The terms of the Senior Loan agreement required us to enter into an interest rate protection agreement. As such, we entered into an interest rate swap agreement with Wachovia (the Wachovia Interest Rate Swap ) to hedge exposure to changing interest rates. The Wachovia Interest Rate Swap has an effective date of October 16, 2007 and runs through the Senior Loan Maturity Date. From October 25, 2008 through the Senior Loan Maturity Date, the notional amount covered by the Wachovia Interest Rate Swap equals \$106.0 million. Under the terms of the Wachovia Interest Rate Swap, from October 25, 2008, through the Senior Loan Maturity Date, we will pay interest at a fixed rate of 4.905% per annum and receive LIBOR-based interest payments based on \$106.0 million of the Senior Loan. The Wachovia Interest Rate Swap effectively fixes the LIBOR rate on \$106.0 million of the Senior Loan at 4.905%. On January 23, 2009, we entered into an interest rate swap agreement with CoBank (the CoBank Interest Rate Swap ) to hedge our exposure to changing interest rates on \$75.0 million of the Senior Loan subject to a variable interest rate. The CoBank Interest Rate Swap has an effective date of February 24, 2009 and matures on February 24, 2010. Under the terms of the CoBank Interest Rate Swap, we will pay interest at a fixed rate of 1.14% per annum and receive LIBOR-based interest payments from CoBank on \$75.0 million of the Senior Loan. The CoBank Interest Rate Swap effectively fixes the LIBOR rate on \$75.0 million of the Senior Loan at 1.14% through February 24, 2010. The remaining amount outstanding under the Senior Loan will bear interest at LIBOR plus margin.

Approximately \$221.0 million of our total debt outstanding as of June 30, 2009 is subject to fixed rates, either directly or when coupled with an interest rate swap. As of June 30, 2009, these balances incurred interest expense at an average rate of 5.96% and mature at dates ranging from 2009 through 2010. A change in the market interest rate impacts the net financial instrument position of our fixed-rate debt portfolio; however, it has no impact on interest incurred or cash flows.

As of June 30, 2009, after consideration of interest rate swaps, approximately \$21.4 million is subject to variable interest rates. As such, a 1.0% change in interest rates would result in a change in interest expense of approximately \$0.2 million per year. The amounts outstanding on our variable-rate debt facilities in the future will be largely dependent upon the level of investor proceeds raised under our Offerings and the rate at which we are able to employ such proceeds in the acquisition of timberland properties and toward repayment of variable-rate debt.

---

**Table of Contents**

**ITEM 4T. CONTROLS AND PROCEDURES**

**Management's Conclusions Regarding the Effectiveness of Disclosure Controls and Procedures**

We carried out an evaluation, under the supervision and with the participation of management, including the Principal Executive Officer and Principal Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) as of the end of the period covered by this quarterly report. Based upon that evaluation, the Principal Executive Officer and Principal Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this quarterly report in providing a reasonable level of assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods in SEC rules and forms, including providing a reasonable level of assurance that information required to be disclosed by us in such reports is accumulated and communicated to our management, including our Principal Executive Officer and our Principal Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

**Changes in Internal Control Over Financial Reporting**

There were no changes in our internal control over financial reporting that occurred during the quarter ended June 30, 2009 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

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

**ITEM 1A. RISK FACTORS**

There have been no material changes from the risk factors disclosed in the Risk Factors section of our annual report on Form 10-K for the year ended December 31, 2008, as amended.

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

(a) All equity securities sold by us in the quarter ended June 30, 2009 were sold in an offering registered under the Securities Act of 1933.

(b) On August 11, 2006, the Registration Statement on Form S-11 (File No. 333-129651) filed with the SEC for our Initial Public Offering was declared effective. WIS is serving as the dealer-manager for our Initial Public Offering. Pursuant to our Initial Public Offering, we are offering a total of up to 85 million shares of our common stock, with 75 million shares being offered at \$10.00 per share in our primary offering and 10 million shares being offered at \$9.55 per share pursuant to our distribution reinvestment plan, aggregating up to \$845.5 million. The offering is expected to terminate on August 11, 2009.

As of June 30, 2009, we had sold approximately 16.6 million shares of common stock in our Initial Public Offering, raising gross offering proceeds of approximately \$165.4 million. From this amount, we incurred approximately \$13.9 million in selling commissions and dealer-manager fees to WIS, approximately \$2.0 million in organization and offering costs to Wells TIMO, and approximately

**Table of Contents**

\$0.4 million for share redemptions. We used the net proceeds of approximately \$149.1 million from the sale of our common stock and proceeds of approximately \$42.8 million from the sale of our preferred stock in private transactions to partially fund the Mahrt Timberland acquisition, pay down the Mezzanine Loan by approximately \$120.0 million, and fund interest payments on the Mezzanine Loan.

(c) During the quarter ended June 30, 2009, we redeemed shares as follows:

Period	Total Number of Shares Redeemed	Average Price Paid per Share	Total Number of Shares Purchased as Part of a Publicly Announced Plan or Program	Approximate Dollar Value of Shares Available That May Yet Be Redeemed Under the Program
April 2009				(1)
May 2009				(1)
June 2009	7,220	\$ 10.00	7,220	(1)

(1) The commencement of our share redemption plan was announced on August 11, 2006. Our share redemption plan limits redemptions of our common stock as follows: the shares redeemed under the share redemption plan cannot exceed the lesser of (i) the amount redeemable from the sum of net proceeds from the sale of shares through the distribution reinvestment plan plus any additional amounts reserved for redemptions by Wells Timberland REIT's board of directors, or (ii) in any calendar year, 5% of the weighted-average common shares outstanding during the preceding year. The terms of the Mezzanine Loan obtained in connection with the acquisition of the Mahrt Timberland prohibit Wells Timberland REIT from making redemptions, other than upon the death or qualifying disability of a stockholder, until this loan is repaid in full (see Note 4 of the accompanying consolidated financial statements). Redemptions sought within two years of the death or qualifying disability of a stockholder do not require a one-year holding period and are subject only to the overall limitation that, during any calendar year, aggregate redemptions may not exceed 100% of the net proceeds from our distribution reinvestment plan during the calendar year and any additional amounts reserved for such purpose by our board of directors. On June 12, 2009, Wells Timberland REIT's board of directors approved a monthly, non-cumulative reserve of \$150,000 for death or qualifying disability redemptions of common stock.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

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

(b) Not applicable.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

Not applicable.

**ITEM 5. OTHER INFORMATION**

(a) During the second quarter of 2009, there was no information that was required to be disclosed in a report on Form 8-K that was not disclosed in a report on Form 8-K or in Item 9B of our Annual Report on Form 10-K for the year ended December 31, 2008, as amended by Amendment No. 1 filed April 14, 2009.



## **Table of Contents**

### **Amendment and Restatement of Our Charter**

On August 5, 2009, at the annual meeting of our stockholders, our stockholders approved the Fourth Articles of Amendment and Restatement to our charter. The Fourth Articles of Amendment and Restatement were filed with the State Department of Assessments and Taxation of Maryland on August 6, 2009, and are effective immediately. The Fourth Articles of Amendment and Restatement amend and restate the Third Articles of Amendment and Restatement to: (1) reinstate the stock ownership and transfer restrictions included in our charter to assist us in continuing to meet the stock ownership requirements for REIT qualification, (2) require compliance with the SEC's tender offer regulations under the Exchange Act for any tender offer made for our shares regardless of the size of the tender offer, and (3) make certain ministerial revisions and clarifications.

The information set forth above with respect to the Fourth Articles of Amendment and Restatement does not purport to be complete in scope and is qualified in its entirety by the full text of the Fourth Articles of Amendment and Restatement, which is filed as Exhibit 3.1 hereto and is incorporated into this report by reference.

### **Amendment and Restatement of Our Bylaws**

On August 5, 2009, at a meeting of our board of directors, our board of directors authorized and approved the Second Amended and Restated Bylaws, which amend and restate the First Amended and Restated Bylaws, adopted by our board of directors on March 27, 2007, as amended to date. The Second Amended and Restated Bylaws are effective immediately upon adoption. Among other things, the Second Amended and Restated Bylaws: (1) reflect amendments to the Maryland General Corporation Law since adoption of the First Amended and Restated Bylaws, (2) address recent developments in public company governance, (3) clarify certain corporate procedures and (4) make certain other enhancements and technical corrections. Revisions to the bylaws, beyond certain clarifications, include:

the deletion of the requirement that our secretary refrain from mailing the notice of a stockholder-requested special meeting until after the payment by the stockholders making the request of the reasonably estimated cost of preparing and mailing notice;

the addition of a provision permitting us to seek reimbursement for the cost of preparing and mailing notice of a stockholder-requested special meeting and clarifying that a special meeting need not be called upon stockholder request if the request is made by one or more stockholders who failed to reimburse us for the cost of preparing and mailing notice of a previously requested special meeting;

the clarification, consistent with our charter, that the presence in person or by proxy of stockholders entitled to cast 50% of all the votes entitled to be cast at a meeting on any matter will constitute a quorum;

the expansion of information required to be provided by stockholders submitting director nominations or business proposals, including disclosure of the stockholder's investment strategy or objective, and the inclusion of procedures for the update of information provided by the stockholder submitting the director nomination or business proposal;

the clarification that, on any matter for which our charter requires the approval of the independent directors, the action of a majority of the total number of independent directors will be the action of the independent directors;

## **Table of Contents**

the clarification that directors and officers may rely on information prepared or presented by others whom the director or officer reasonably believes to be reliable and competent in the matters presented;

the addition of a provision that authorizes our board of directors or stockholders to ratify any action or inaction by us or our officers to the extent that our board of directors or stockholders could have originally authorized the matter; and

the clarification that our board of directors may change the membership of any committee, fill any vacancy on a committee or dissolve any committee.

The information set forth above with respect to the Second Amended and Restated Bylaws does not purport to be complete in scope and is qualified in its entirety by the full text of the Second Amended and Restated Bylaws, which is filed as Exhibit 3.2 hereto and are incorporated into this report by reference.

### **Amendment and Restatement of Our Operating Partnership Agreement**

On August 5, 2009, we entered into the Third Amended and Restated Agreement of Limited Partnership of Wells Timberland Operating Partnership, L.P. which amends and restates the Second Amended and Restated Agreement of Limited Partnership dated March 27, 2007. Among other things, the Third Amended and Restated Agreement of Limited Partnership creates Series A and Series B preferred partnership units, which mirror the terms of the shares of our Series A preferred stock and Series B preferred stock, the rights, privileges and preferences of which are defined by the Articles Supplementary dated September 28, 2007 and August 28, 2008, respectively. In addition, the Third Amended and Restated Agreement of Limited Partnership clarifies the circumstances under which the special units are redeemed and a one-time payment is made to the holder of the special units.

The information set forth above with respect to the Third Amended and Restated Agreement of Limited Partnership does not purport to be complete in scope and is qualified in its entirety by the full text of the Third Amended and Restated Agreement of Limited Partnership, which is filed as Exhibit 10.3 hereto and are incorporated into this report by reference.

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

### **ITEM 6. EXHIBITS**

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



**Table of Contents**

**SIGNATURES**

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

**WELLS TIMBERLAND REIT, INC.**

(Registrant)

Date: August 5, 2009

By: /s/ DOUGLAS P. WILLIAMS  
Douglas P. Williams

Executive Vice President, Secretary, Treasurer and Principal  
Financial Officer

**Table of Contents**

**EXHIBIT INDEX TO  
SECOND QUARTER 2009 FORM 10-Q OF  
WELLS TIMBERLAND REIT, INC.**

**Exhibit**

<b>Number</b>	<b>Description</b>
3.1*	Fourth Articles of Amendment and Restatement
3.2*	Second Amended and Restated Bylaws
3.3	Articles Supplementary dated September 28, 2007 (incorporated by reference to Exhibit 3.4 to Post Effective Amendment No. 3)
3.4	Articles Supplementary dated August 28, 2008 (incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K dated August 28, 2008 filed on August 29, 2008)
10.1*	Amendment dated April 24, 2009 to the Amended and Restated Long-Term Incentive Plan
10.2	Amended and Restated Master Purchase Agreement dated as of April 8, 2009 by and among Wells-DFH Timberland Nr.88 GmbH & Co. KG, Wells-DFH Materia GmbH & Co. KG, Deutsche Fonds Holding AG, Wells Timberland REIT, Inc. and Wells Timberland Management Organization, LLC (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K dated April 8, 2009 filed on April 10, 2009)
10.3*	Third Amended and Restated Agreement of Limited Partnership of Wells Timberland Operating Partnership, L.P.
31.1*	Certification of the Principal Executive Officer of the Company, pursuant to Securities Exchange Act Rule 13a-14 and 15d-14 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certification of the Principal Financial Officer of the Company, pursuant to Securities Exchange Act Rules 13a-14 and 15d-14 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Statement of the Principal Executive Officer and Principal Financial Officer of the Company, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

\* - Filed herewith

**Table of Contents**

**SUPPLEMENTAL INFORMATION** The prospectus of Wells Timberland REIT, Inc. consists of this sticker, the prospectus dated August 6, 2009 and this Supplement No. 1 dated August 12, 2009.

Supplement No. 1 includes:

the status of our public offerings;

increased suitability standards for investors in the state of Tennessee;

clarifications to certain risk factors;

clarifications to the disclosure in the section of the prospectus entitled "Business and Policies" "Investment Objectives;" and

our Quarterly Report on Form 10-Q for the quarter ended June 30, 2009, as filed with the Securities and Exchange Commission on August 7, 2009, which is attached to this supplement as Annex A.