PACIFIC GAS & ELECTRIC CO
Form 424B5
November 13, 2008

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This preliminary prospectus supplement and the accompanying prospectus relate to an effective registration statement under the Securities Act of 1933, but are not complete and may be changed. This preliminary prospectus supplement and the accompanying prospectus are not an offer to sell these securities and we are not soliciting an offer to buy these securities in any jurisdiction where the offer or sale is not permitted.

Filed Pursuant to Rule 424(b)5
SEC File No. 333-149361

SUBJECT TO COMPLETION, DATED NOVEMBER 13, 2008

PROSPECTUS SUPPLEMENT
(To Prospectus dated February 22, 2008)

$

$ 8.25% Senior Notes due October 15, 2018
$ % Senior Notes due

We are offering $ principal amount of our 8.25% Senior Notes due October 15, 2018, which we refer to in this prospectus supplement as our 2018 notes, and $ principal amount of our % Senior Notes due , 20 , which we refer to in this prospectus supplement as our 20 notes. We collectively refer to both series of senior notes offered hereby as our senior notes.

We will pay interest on our 2018 notes on each April 15 and October 15, beginning on April 15, 2009 and pay interest on our 20 notes on each and , beginning on , 2009. The senior notes will be issued in denominations of $1,000 and integral multiples of $1,000.

The terms of the 2018 notes, other than their issue date and public offering price, will be identical to the terms of the $600,000,000 principal amount of 8.25% Senior Notes due October 15, 2018 offered and sold by our prospectus supplement dated October 16, 2008 and the accompanying prospectus. The 2018 notes offered by this prospectus supplement and the accompanying prospectus will have the same CUSIP number as the other notes of the corresponding series and will trade interchangeably with notes of the same series immediately upon settlement. Upon consummation of this offering, the aggregate principal amount of our 8.25% Senior Notes due October 15, 2018 will be $.

We may redeem the senior notes in whole or in part at any time at the redemption prices set forth in this prospectus supplement.

The senior notes will be unsecured and will rank equally with all of our other unsecured and unsubordinated indebtedness from time to time outstanding.

There is no existing public market for the senior notes. We do not intend to list the senior notes on any securities exchange or any automated quotation system.

Investing in these senior notes involves risks. See Risk Factors on page S-3.

	Per 2018 Note	Total	Per 20 Note	Total
Public Offering Price[(1)]	%	$	%	$
Underwriting Discount	%	$	%	$
Proceeds to Pacific Gas and Electric Company (before expenses)[(1)]	%	$	%	$

(1) Plus accrued interest, with respect to the 2018 notes, from and including October 21, 2008 to but excluding the delivery date (totaling $), and, with respect to the 20 notes, plus accrued interest, if any, from and including original issuance of the 20 notes. Accrued interest must be paid by the purchasers of the 2018 notes, and must be paid by the purchasers of the 20 notes in the event the 20 notes are delivered after November , 2008.

None of the Securities and Exchange Commission, any state securities commission or any other regulatory body has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus supplement or the accompanying prospectus. Any representation to the contrary is a criminal offense.

The senior notes are expected to be delivered on or about November , 2008 through the book-entry facilities of The Depository Trust Company.

Joint Book-Running Managers

J.P. Morgan **Morgan Stanley** **RBS Greenwich Capital**

Co-Managers

Wells Fargo Securities

Loop Capital Markets, LLC **The Williams Capital Group, L.P.**

November , 2008

This prospectus supplement should be read in conjunction with the accompanying prospectus. You should rely only on the information contained in this prospectus supplement, the accompanying prospectus and the information incorporated by reference. Neither we nor any underwriter has authorized any other person to provide you with different or additional information. If anyone provides you with different or additional information, you should not rely on it. Neither we nor any underwriter is making an offer to sell the senior notes in any jurisdiction where the offer or sale is not permitted. You should assume that the information contained in this prospectus supplement and the accompanying prospectus is accurate only as of the date hereof.

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Unless otherwise indicated, when used in this prospectus supplement and the accompanying prospectus, the terms we, our and us refer to Pacific Gas and Electric Company and its subsidiaries.

This prospectus supplement and the accompanying prospectus contain forward-looking statements that are necessarily subject to various risks and uncertainties. Forward-looking statements in this prospectus supplement are based on current estimates, expectations and projections about future events, and assumptions regarding these events and management s knowledge of facts as of the date of this prospectus supplement. These forward-looking statements relate to, among other matters, estimated capital expenditures, our estimated rate base, estimated environmental remediation liabilities, the anticipated outcome of various regulatory and legal proceedings, future cash flows, and the level of future equity or debt issuances, and are also identified by words such as assume, expect, intend, plan, pro believe, estimate, predict, anticipate, aim, may, might, should, would, could, goal, potential We are not able to predict all the factors that may affect future results. See Forward-Looking Statements in the accompanying prospectus, for some of the factors that could cause future results to differ materially from those expressed or implied by the forward-looking statements, or from historical results.

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RISK FACTORS

Investing in the senior notes involves risk. These risks are described under Risk Factors in Item 1A of our annual report on Form 10-K for the fiscal year ended December 31, 2007 and in Item 1A of our quarterly report on Form 10-Q for the period ended September 30, 2008, which are incorporated by reference in this prospectus supplement and the accompanying prospectus. See Where You Can Find More Information in the accompanying prospectus. Before making a decision to invest in the senior notes, you should carefully consider these risks as well as other information contained or incorporated by reference in this prospectus supplement and the accompanying prospectus.

OUR COMPANY

We are a leading vertically integrated electricity and natural gas utility. We were incorporated in California in 1905 and are a subsidiary of PG&E Corporation. We operate in northern and central California and are engaged in the businesses of electricity and natural gas distribution, electricity generation, procurement and transmission, and natural gas procurement, transportation and storage. At September 30, 2008, we served approximately 5.1 million electricity distribution customers and approximately 4.3 million natural gas distribution customers. Our principal executive office is located at 77 Beale Street, P.O. Box 770000, San Francisco, California 94177, and our telephone number is (415) 973-7000. The principal executive office of PG&E Corporation is located at One Market, Spear Tower, Suite 2400, San Francisco, California 94105.

RATIO OF EARNINGS TO FIXED CHARGES

The following table sets forth our historical ratio of earnings to fixed charges for each of the fiscal years indicated and for the nine months ended September 30, 2008.

Nine months ended September 30, 2008	2007	2006	2005	2004	2003
2.99x	2.79x	2.98x	3.56x	10.75x	2.51x

For the purpose of computing our ratio of earnings to fixed charges, earnings represent net income adjusted for the minority interest in losses of less than 100% owned affiliates, equity in undistributed income or losses of less than 50% owned affiliates, income taxes and fixed charges (excluding capitalized interest). Fixed charges include interest on long-term debt and short-term borrowings (including a representative portion of rental expenses), amortization of bond premium, discount and expense, interest on capital leases, allowance for funds used during construction debt, and earnings required to cover the preferred stock dividend requirements and preferred security distribution requirements of a majority-owned trust. Fixed charges exclude interest on Financial Accounting Standards Board Interpretation No. 48 (Accounting for Uncertainty in Income Taxes) tax liabilities.

USE OF PROCEEDS

We estimate that the net proceeds from this offering will be approximately $ million, after deducting underwriting discounts and commissions and estimated offering expenses payable by us. We intend to use the net proceeds from the sale of the senior notes to repay all or a portion of our senior notes due March 1, 2009 which bear interest at 3.6% per annum and for general corporate purposes.

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CAPITALIZATION

The following table sets forth our consolidated capitalization as of September 30, 2008, and as adjusted to give effect to the issuance and sale of the senior notes and the use of proceeds from this offering as set forth under Use of Proceeds above. This table should be read in conjunction with our consolidated condensed financial statements and related notes as of and for the nine months ended September 30, 2008, incorporated by reference in this prospectus supplement and the accompanying prospectus. See Where You Can Find More Information in the accompanying prospectus.

	As of September 30, 2008	
	Actual	As Adjusted
	(in millions)	
Current Liabilities:		
Short-term borrowings(1)	$ 1,335	$
Long-term debt, classified as current:		
Current portion of long-term debt(2)	600	
Current portion of energy recovery bonds(3)	366	
Total long-term debt, classified as current	$ 966	$
Capitalization:		
Long-term debt(4)	$ 7,536	$
Energy recovery bonds(3)	1,310	
Shareholders equity(5)	9,661	
Total capitalization	$ 18,507	$

(1) Actual short-term borrowings consisted of $802 million of commercial paper and $533 million of borrowings outstanding under our $2.0 billion working capital facility. As adjusted short-term borrowings gives effect to the use of proceeds from $600 million of our senior notes issued on October 21, 2008 and $309 million of tax-exempt pollution control refunding bonds issued for our benefit on October 29, 2008, in each case net of any discounts and premiums, to repay short-term debt.
(2) As adjusted current portion of long-term debt gives effect to the use of proceeds to repay such debt.
(3) PG&E Energy Recovery Funding LLC, or PERF, a legally separate but wholly-owned, consolidated subsidiary of ours, issued energy recovery bonds, or ERBs, supported by a dedicated rate component, or DRC, the proceeds of which were used to purchase from us the right, known as recovery property, to be paid a specified amount from a DRC. DRC charges are collected by us and remitted to PERF for payment of the ERBs principal, interest and miscellaneous associated expenses. The ERBs are secured solely by the recovery property. Our creditors have no recourse to the assets of PERF and its creditors have no recourse to our assets.
(4) Actual long-term debt consisted of $1,264 million of pollution control bonds and $6,272 million of senior notes and as adjusted long-term debt also includes $600 million of our senior notes issued on October 21, 2008, $309 million of tax-exempt pollution control refunding bonds issued for our benefit on October 29, 2008 and the senior notes offered hereby, in each case, net of any discounts and premiums.

(5) Includes $258 million of preferred stock without mandatory redemption provisions.

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DESCRIPTION OF THE SENIOR NOTES

General

You should read the following information in conjunction with the statements under Description of the Senior Notes in the accompanying prospectus.

As used in this section, the terms we, us and our refer to Pacific Gas and Electric Company, and not to any of our subsidiaries.

The 2018 notes are being offered in the aggregate principal amount of $ and will mature on October 15, 2018. The 20 notes are being offered in an initial aggregate principal amount of $ and will mature on , 20 .

We will issue the senior notes under an existing indenture, which was originally entered into on March 11, 2004 and amended and restated on April 22, 2005, between us and The Bank of New York Mellon Trust Company, N.A. (formerly known as The Bank of New York Trust Company, N.A.), as trustee, as supplemented by supplemental indentures between us and the trustee. Please read the indenture because it, and not this description, defines your rights as holders of the senior notes. We have filed with the Securities and Exchange Commission a copy of the indenture as an exhibit to the registration statement of which this prospectus supplement and the accompanying prospectus are a part.

Pursuant to the Trust Indenture Act of 1939, as amended, or the 1939 Act, if a default occurs on the senior notes, The Bank of New York Mellon Trust Company, N.A. may be required to resign as trustee under the indenture if it has a conflicting interest (as defined in the 1939 Act), unless the default is cured, duly waived or otherwise eliminated within 90 days.

The 2018 notes form a part of the series of our 8.25% Senior Notes due October 15, 2018 and will have the same terms as the other notes of this series other than their issue date and the public offering price at which the 2018 notes are sold by this prospectus supplement and the accompanying prospectus. We first issued our 8.25% Senior Notes due October 15, 2018 on October 21, 2008. The 2018 notes offered by this prospectus supplement and the accompanying prospectus will have the same CUSIP number as the other notes of the corresponding series and will trade interchangeably with notes of the same series immediately upon settlement. Upon the consummation of this offering, the aggregate principal amount of our 8.25% Senior Notes due October 15, 2018 will be $.

For each series of senior notes, we may without consent of the holders of that series issue additional senior notes of that series under the indenture, as we are doing in this offering with respect to the 2018 notes, having the same terms in all respects to the senior notes of that series (except for the public offering price and the issue date and, in some cases, the first interest payment date) so that those additional notes will be consolidated and form a single series with the other outstanding senior notes of that series.

The 2018 notes will bear interest from October 21, 2008 at 8.25% per annum, payable semiannually on each April 15 and October 15, beginning on April 15, 2009, to holders of record on the 15th day prior to the interest payment date.

The 20 notes will bear interest from , 2008 at % per annum, payable semiannually on each and , beginning on , 2009, to holders of record on the 15th day prior to the interest payment date.

We will issue each series of senior notes in denominations of $1,000 and integral multiples of $1,000.

Each series of senior notes will be redeemable at our option, in whole or in part, at any time as described under Optional Redemption below.

Interest on the senior notes will be computed on the basis of a 360-day year consisting of twelve 30-day months. If any payment date falls on a day that is not a business day, the payment will be made on the next business day, but we will consider that payment as being made on the date that the payment was due to you. In that event, no interest will accrue on the amount payable for the period from and after the payment date.

We will issue the senior notes in the form of one or more global securities, which will be deposited with, or on behalf of, The Depository Trust Company, or DTC, and registered in the name of DTC s nominee. Information regarding DTC s book-entry system is set forth below under Book-Entry System; Global Notes.

Ranking

The senior notes will be our direct, unsecured and unsubordinated obligations and will rank equally with all our other existing and future unsecured and unsubordinated obligations. The senior notes will be effectively subordinated to all our secured debt. As of September 30, 2008, we had approximately $6.9 billion of notes outstanding under the indenture for the senior notes. We issued $600 million of notes under the indenture for the senior notes on October 21, 2008.

As of September 30, 2008, we did not have any outstanding secured debt for borrowed money. The indenture contains no restrictions on the amount of additional indebtedness that may be incurred by us.

Optional Redemption

We may, at our option, redeem the senior notes of each series in whole or in part at any time at a redemption price equal to the greater of:

- 100% of the principal amount of the senior notes to be redeemed; or
- as determined by the Quotation Agent, the sum of the present values of the remaining scheduled payments of principal and interest on the senior notes to be redeemed (not including any portion of payments of interest accrued as of the redemption date) discounted to the redemption date on a semiannual basis at the Adjusted Treasury Rate plus 50 basis points in the case of the 2018 notes, and plus basis points in the case of the 20 notes,

plus, in each case, accrued and unpaid interest to the redemption date.

The redemption price will be calculated assuming a 360-day year consisting of twelve 30-day months.

We will mail notice of any redemption at least 30 days but not more than 60 days before the redemption date to each registered holder of the senior notes to be redeemed.

Unless we default in payment of the redemption price, on and after the redemption date, interest will cease to accrue on the senior notes or portions of the senior notes called for redemption.

Adjusted Treasury Rate means, with respect to any redemption date, the rate per annum equal to the semiannual equivalent yield to maturity of the Comparable Treasury Issue, assuming a price for the Comparable Treasury Issue (expressed as a percentage of its principal amount) equal to the Comparable Treasury Price for the redemption date.

Business Day means any day that is not a day on which banking institutions in New York City are authorized or required by law or regulation to close.

Comparable Treasury Issue means the United States Treasury security selected by the applicable Quotation Agent as having a maturity comparable to the remaining term of the senior notes to be redeemed that would be used, at the time of selection and in accordance with customary financial practice, in pricing new issues of corporate debt securities of comparable maturity to the remaining term of the senior notes to be redeemed.

Comparable Treasury Price means, with respect to any redemption date:

- the average of the Reference Treasury Dealer Quotations for that redemption date, after excluding the highest and lowest of the Reference Treasury Dealer Quotations; or

- if we obtain fewer than four Reference Treasury Dealer Quotations, the average of all Reference Treasury Dealer Quotations so received.

Quotation Agent with respect to each series of senior notes means the Reference Treasury Dealer appointed by us for that series.

Reference Treasury Dealer with respect to the 2018 notes, means (1) each of Banc of America Securities LLC, Citigroup Global Markets, Inc. and Deutsche Bank Securities Inc. and their respective

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successors, unless any of them ceases to be a Primary Treasury Dealer, in which case we shall substitute another Primary Treasury Dealer; and (2) any other Primary Treasury Dealer selected by us.

Reference Treasury Dealer with respect to the 20 notes means (1) each of J.P. Morgan Securities Inc., Morgan Stanley & Co. Incorporated and Greenwich Capital Markets, Inc. and their respective successors, unless any of them ceases to be a Primary Treasury Dealer, in which case we shall substitute another Primary Treasury Dealer; and (2) any other Primary Treasury Dealer selected by us.

Reference Treasury Dealer Quotations means, with respect to each Reference Treasury Dealer and any redemption date, the average, as determined by us, of the bid and asked prices for the Comparable Treasury Issue (expressed in each case as a percentage of its principal amount) quoted in writing to us by that Reference Treasury Dealer at 5:00 p.m., New York City time, on the third Business Day preceding that redemption date.

If we redeem only some of the senior notes of a series, DTC s practice is to choose by lot the amount to be redeemed from the senior notes of that series held by each of its participating institutions. DTC will give notice to these participants, and these participants will give notice to any street name holders of any indirect interests in the senior notes to be redeemed according to arrangements among them. These notices may be subject to statutory or regulatory requirements. We will not be responsible for giving notice of a redemption of the senior notes of a series to be redeemed to anyone other than the registered holders of the senior notes of that series to be redeemed, which is currently DTC. If senior notes of a series to be redeemed are no longer held through DTC and fewer than all the senior notes of that series are to be redeemed, selection of senior notes for redemption will be made by the trustee in any manner the trustee deems fair and appropriate.

Subject to the foregoing and to applicable law (including, without limitation, United States federal securities laws), we or our affiliates may, at any time and from time to time, purchase outstanding senior notes by tender, in the open market or by private agreement.

No Sinking Fund

There is no provision for a sinking fund for either series of the senior notes.

Covenants

The indenture restricts us and any of our subsidiaries which are significant subsidiaries from incurring or assuming secured debt or entering into sale and leaseback transactions, except in certain circumstances. The accompanying prospectus describes this covenant (see Restrictions on Liens and Sale and Leaseback Transactions in the accompanying prospectus) and other covenants contained in the indenture in greater detail and should be read prior to investing.

Book-Entry System; Global Notes

Except as set forth below, the senior notes of each series will initially be issued in the form of one or more global notes. Each series of senior notes will be issued as fully-registered securities registered in the name of Cede & Co. (DTC s partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered security certificate will be issued for each series of the senior notes in the aggregate principal amount of such series, and will be deposited with DTC or the trustee on behalf of DTC. If, however, the aggregate principal amount of any series exceeds $500 million, one certificate will be issued with respect to each $500 million of principal amount and an additional certificate will be issued with respect to any remaining principal amount of such series. Investors may hold their beneficial interests in a global note directly through DTC or indirectly through organizations which are participants in the DTC system.

Unless and until they are exchanged in whole or in part for certificated notes, the global notes may not be transferred except as a whole by DTC or its nominee.

DTC has advised us as follows:

> DTC is a limited purpose trust company organized under the New York Banking Law, a banking organization within the meaning of the New York Banking Law, a member of the Federal Reserve System, a clearing corporation within the meaning of the New York Uniform Commercial Code and

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a clearing agency registered under the provisions of Section 17A of the Securities Exchange Act of 1934.

DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity, corporate and municipal debt issues, and money market instrument from over 100 countries that DTC s direct participants deposit with DTC. DTC also facilitates the post-trade settlement among direct participants of sales and other securities transactions in deposited securities through electronic computerized book-entry transfers and pledges between direct participants accounts. This eliminates the need for physical movement of securities certificates. Direct participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations and certain other organizations. DTC is a wholly owned subsidiary of The Depository Trust & Clearing Corporation, or DTCC. DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others, such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies and clearing corporations that clear through or maintain a custodial relationship with a direct participant, either directly or indirectly. DTC has S&P s highest rating: AAA. The DTC rules applicable to its direct and indirect participants are on file with the SEC. More information about DTC can be found at www.dtcc.com and www.dtc.org.

Purchases of the senior notes under the DTC system must be made by or through direct participants, which will receive a credit for the senior notes on DTC s records. The ownership interest of each actual purchaser of each senior note, or the beneficial owner, is, in turn, to be recorded on the direct and indirect participants records. Beneficial owners will not receive written confirmation from DTC of their purchase. Beneficial owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the direct or indirect participant through which the beneficial owner entered into the transaction. Transfers of ownership interests in the senior notes are to be accomplished by entries made on the books of direct and indirect participants acting on behalf of beneficial owners. Beneficial owners will not receive certificates representing their ownership interests in senior notes, except in the event that use of the book-entry system for the senior notes is discontinued.

To facilitate subsequent transfers, all senior notes deposited by direct participants with DTC are registered in the name of DTC s partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of senior notes with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual beneficial owners of the senior notes; DTC s records reflect only the identity of the direct participants to whose accounts the senior notes are credited, which may or may not be the beneficial owners. The direct and indirect participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to direct participants, by direct participants to indirect participants, and by direct participants and indirect participants to beneficial owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial owners of the senior notes may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the senior notes, such as redemptions, tenders, defaults and proposed amendments to the senior note documents. For example, beneficial owners of senior notes may wish to ascertain whether the nominee holding the senior notes for their benefit has agreed to obtain and transmit notices to beneficial owners. In the alternative, beneficial owners may wish to provide their names and addresses to the registrar and request that copies of notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the senior notes within a series are being redeemed, DTC s practice is to determine by lot the amount of the interest of each direct participant in the series to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to senior notes unless authorized by a direct participant in accordance with DTC s MMI procedures. Under its usual procedures, DTC mails an omnibus proxy to the issuer as soon as possible after the record date.

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The omnibus proxy assigns Cede & Co. s consenting or voting rights to those direct participants to whose accounts senior notes are credited on the record date (identified in a listing attached to the omnibus proxy).

Redemption proceeds, distributions and dividend payments on the senior notes will be made to Cede & Co. or such other nominee as may be requested by an authorized representative of DTC. DTC s practice is to credit direct participants accounts upon DTC s receipt of funds and corresponding detail information from the issuer or the agent on payable date in accordance with their respective holdings shown on DTC s records. Payments by participants to beneficial owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in street name, and will be the responsibility of the participant and not of DTC nor its nominee, agent or the issuer, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, distributions and dividend payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the issuer or agent, disbursement of the payments to direct participants will be the responsibility of DTC, and disbursement of such payments to the beneficial owners will be the responsibility of direct and indirect participants.

DTC may discontinue providing its services as depositary with respect to the senior notes at any time by giving reasonable notice to the issuer or the agent. Under such circumstances, in the event that a successor depositary is not obtained, senior note certificates are required to be printed and delivered.

We may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depositary). In that event, senior note certificates will be printed and delivered.

The information in this section concerning DTC and DTC s book-entry system has been obtained from sources that we believe to be reliable but we take no responsibility for the accuracy thereof.

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CERTAIN UNITED STATES FEDERAL INCOME TAX CONSEQUENCES

The following summary describes certain United States federal income tax consequences of the acquisition, ownership and disposition of the senior notes as of the date hereof. This summary is based on the Internal Revenue Code of 1986, as amended, as well as final, temporary and proposed Treasury regulations and administrative and judicial decisions. Legislative, judicial and administrative changes may occur, possibly with retroactive effect, that could affect the accuracy of the statements described herein. This summary generally is addressed only to original purchasers of the senior notes, deals only with senior notes held as capital assets and does not purport to address all United States federal income tax matters that may be relevant to investors in special tax situations, such as insurance companies, tax-exempt organizations, financial institutions, dealers in securities or currencies, traders in securities that elect to mark to market, holders of senior notes that are held as a hedge or as part of a hedging, straddle or conversion transaction, certain former citizens or residents of the United States, or United States holders (as defined below) whose functional currency is not the United States dollar. **Persons considering the purchase of the senior notes should consult their own tax advisors concerning the application of United States federal income tax laws, as well as the laws of any state, local or foreign taxing jurisdictions, to their particular situations.**

If a partnership (including an entity treated as a partnership for United States federal income tax purposes) is a beneficial owner of a senior note, the treatment of a partner in the partnership will generally depend upon the status of the partner and upon the activities of the partnership. A beneficial owner of a senior note that is a partnership, and partners in such a partnership, should consult their tax advisors about the United States federal income tax consequences of holding and disposing of the senior notes.

We intend to treat the 2018 notes as being issued in a qualified reopening for United States federal income tax purposes. Consequently, we intend to treat the 2018 notes as part of the same issue for United States federal income tax purposes as the 8.25% Senior Notes due October 15, 2018. The aggregate price paid for the 2018 notes will include pre-issuance accrued interest from October 21, 2008. Such pre-issuance accrued interest will be included in the first interest payment that will be made on April 15, 2009 to the holders of the 2018 notes. We will exclude the pre-issuance accrued interest in determining the issue price of the 2018 notes and, in accordance with this treatment, holders of the 2018 notes will be required to treat a corresponding portion of the interest payable on the first interest payment date as a non-taxable return of the excluded pre-issuance accrued interest, rather than as an amount payable on the 2018 notes.

United States Holders

This section describes the tax consequences to a United States holder. A United States holder is a beneficial owner of a senior note that is (i) a citizen or resident of the United States, (ii) a corporation (including an entity treated as a corporation for United States federal income tax purposes) created or organized in the United States or any state (including the District of Columbia), (iii) an estate whose income is subject to United States federal income tax on a net income basis in respect of the senior note, or (iv) a trust if a United States court can exercise primary supervision over the trust s administration and one or more United States persons are authorized to control all substantial decisions of the trust (or certain trusts that have made a valid election to be treated as a United States person).

If you are not a United States holder, this section does not apply to you. See Non-United States Holders below.

Payment of Interest

We do not believe that the senior notes will be issued with more than a *de minimis* amount of original issue discount, if any. Interest on a senior note will therefore be taxable to a United States holder as ordinary interest income at the time it accrues or is received, in accordance with the United States holder s method of accounting for United States federal income tax purposes.

Sale, Exchange or Retirement of Senior Notes

Upon the sale, exchange or retirement of a senior note, a United States holder will recognize taxable gain or loss equal to the difference between the amount realized from the sale, exchange, retirement or other disposition (other than amounts attributable to accrued interest not previously included in income, which will

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be taxable as ordinary interest income) and the United States holder s adjusted tax basis in the senior note. A United States holder s adjusted tax basis in a senior note will generally equal the cost of the senior note to such holder (excluding amounts attributable to pre-issuance accrued interest) increased by the amount of any accrued but unpaid interest previously included in income. Such gain or loss generally will be capital gain or loss, and will be long-term capital gain or loss if the senior note has been held for more than one year. Capital losses are subject to certain limitations.

Amortizable Bond Premium

A United States holder who acquires a 2018 note for an amount that is greater than the stated principal amount (in excess of pre-issuance accrued interest) on the 2018 note will be considered to have purchased such note at a premium. A United States holder generally may elect to amortize such premium using a constant yield method over the remaining term of the 2018 note as an offset to interest when includible in income under the United States holder s method of accounting for United States federal income tax purposes. Any such election shall apply to all debt instruments (other than debt instruments the interest on which is excludable from gross income) held at the beginning of the first taxable year to which the election applies or thereafter acquired, and is irrevocable without the consent of the Internal Revenue Service. However, because the 2018 notes may be redeemed by us under certain circumstances in an amount greater than par prior to their maturity date, special rules may affect the amount and timing of any deduction attributable to bond premium. United States holders that acquire the 2018 notes for an amount that is greater than the stated principal amount (in excess of pre-issuance accrued interest) on the 2018 note should consult with their own tax advisor regarding the consequences of making the amortizable bond premium election and the availability of other elections for United States federal income tax purposes.

Non-United States Holders

This section describes the tax consequences to a non-United States holder. You are a non-United States holder if you are the beneficial owner of a senior note (other than a partnership) and are not a United States holder for United States federal income tax purposes.

Payment of Interest

A non-United States holder generally will not be subject to United States federal withholding tax with respect to payments of principal and interest on the senior notes, provided that (i) the non-United States holder does not actually or constructively own 10 percent or more of the total combined voting power of all classes of our stock entitled to vote, (ii) the non-United States holder is not for United States federal income tax purposes a controlled foreign corporation related to us (directly or indirectly) through stock ownership, and (iii) the beneficial owner of the senior notes certifies to us or the fiscal and paying agent (on Internal Revenue Service Form W-8BEN or applicable form) under penalties of perjury as to its status as a non-United States holder and complies with applicable identification procedures. Special rules apply to partnerships, estates and trusts and, in certain circumstances, certifications as to foreign status and other matters may be required to be provided by partners and beneficiaries thereof.

Sale, Exchange or Retirement of Senior Notes

A non-United States holder of a senior note generally will not be subject to United States federal income tax on any gain realized upon the sale, exchange, retirement or other disposition of a senior note, unless the non-United States holder is an individual who is present in the United States for 183 days or more during the taxable year of sale, retirement or other disposition and certain other conditions are met. In such case, the non-United States holder generally will be subject to a 30% tax on any capital gain recognized on the disposition of the senior notes, after being offset by certain United States source capital losses.

United States Trade or Business

If a non-United States holder of a senior note is engaged in a trade or business in the United States and income or gain from the senior note is effectively connected with the conduct of such trade or business, the

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non-United States holder will be exempt from withholding tax if appropriate certification has been provided, but will generally be subject to regular United States federal income tax on such income and gain in the same manner as if it were a United States holder. In addition, if such non-United States holder is a foreign corporation, it may be subject to a branch profits tax equal to 30 percent (or lower applicable treaty rate) of its effectively connected earnings and profits for the taxable year, subject to adjustments.

Backup Withholding and Information Reporting

In general, payments of interest and the proceeds of sale, exchange, retirement or other disposition of the senior notes payable by a United States paying agent or other United States intermediary will be subject to information reporting. With respect to a non-United States holder, we must report annually to the Internal Revenue Service and to each non-United States holder the amount of any interest paid to such holder regardless of whether any tax was actually withheld. Copies of the information returns reporting such interest payments to a non-United States holder and the amount of any tax withheld also may be made available to the tax authorities in the country in which the non-United States holder resides under the provisions of an applicable income tax treaty. In addition, backup withholding at the then applicable rate (currently 28%) will generally apply to these payments if:

- in the case of a United States holder, the holder fails to provide an accurate taxpayer identification number, fails to certify that the holder is not subject to backup withholding or fails to report all interest and dividends required to be shown on its United States federal income tax returns; or

- in the case of a non-United States holder, the holder fails to provide the certification on Internal Revenue Service Form W-8BEN described above or otherwise does not provide evidence of exempt status.

Certain United States holders (including, among others, corporations) are not subject to information reporting or backup withholding. Any amount paid as backup withholding will be creditable against the holder s United States federal income tax liability and may entitle the holder to a refund, provided that the required information is timely furnished to the Internal Revenue Service. Holders of the senior notes should consult their tax advisors as to their qualification for exemption from backup withholding and the procedure for obtaining such an exemption.

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UNDERWRITING

Subject to the terms and conditions set forth in an underwriting agreement between us and the underwriters named below, for whom J.P. Morgan Securities Inc., Morgan Stanley & Co. Incorporated and Greenwich Capital Markets, Inc. are acting as representatives, we have agreed to sell to each of the underwriters, and each of the underwriters has severally and not jointly agreed to purchase from us, the principal amount of senior notes of each series set forth opposite its name below.

Underwriter	Principal Amount of 2018 Notes	Principal Amount of 20 Notes
J.P. Morgan Securities Inc.	$	$
Morgan Stanley & Co. Incorporated		
Greenwich Capital Markets, Inc.		
Wells Fargo Securities, LLC		
Loop Capital Markets, LLC		
The Williams Capital Group, L.P.		
Total	$	$

The underwriters have agreed, subject to the terms and conditions set forth in the underwriting agreement, to purchase all of the senior notes if any of the senior notes are purchased.

The underwriters propose to offer each series of the senior notes directly to the public at the respective public offering prices specified on the cover page to this prospectus supplement and may also offer the senior notes to certain dealers at the respective public offering prices less concessions not to exceed % of the principal amount of the 2018 notes, and % of the principal amount of the 20 notes. The underwriters may allow, and these dealers may reallow, concessions to certain brokers and dealers not to exceed % of the principal amount of the 2018 notes
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COMMITMENTS AND CONTINGENCIES (Notes 11 and 12)

SHAREHOLDERS' EQUITY

Common Shares, 480,000,000 shares authorized, 126,802,309 and 126,773,097 shares issued and outstanding
703,588

702,598

Retained earnings	776,827	790,697
Accumulated other comprehensive loss	(15,088)	(4,825)
TOTAL RAYONIER INC. SHAREHOLDERS’ EQUITY	1,465,327	1,488,470
Noncontrolling interest	82,889	86,681
TOTAL SHAREHOLDERS’ EQUITY	1,548,216	1,575,151
TOTAL LIABILITIES AND SHAREHOLDERS’ EQUITY	$2,412,550	$2,453,115

See Notes to Consolidated Financial Statements.

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RAYONIER INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(Dollars in thousands)

	Three Months Ended March 31, 2015	Three Months Ended March 31, 2014
OPERATING ACTIVITIES		
Net income	$18,180	$41,343
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation, depletion and amortization	29,975	25,981
Non-cash cost of land sold and real estate development costs recovered upon sale	3,747	3,076
Stock-based incentive compensation expense	805	3,103
Deferred income taxes	(189)	5,596
Non-cash adjustments to unrecognized tax benefit liability	—	(3,896)
Depreciation and amortization from discontinued operations	—	20,649
Amortization of losses from pension and postretirement plans	939	3,028
Other	105	2,368
Changes in operating assets and liabilities:		
Receivables	3,544	(15,950)
Inventories	(3,133)	(950)
Accounts payable	2,857	13,929
Income tax receivable/payable	(150)	1,319
All other operating activities	(3,282)	3,002
Expenditures for dispositions and discontinued operations	—	(2,498)
CASH PROVIDED BY OPERATING ACTIVITIES	53,398	100,100
INVESTING ACTIVITIES		
Capital expenditures	(13,292)	(34,640)
Real estate development costs	(306)	(1,812)
Purchase of timberlands	(23,070)	(10,637)
Change in restricted cash	(7,071)	45,312
Other	—	(778)
CASH USED FOR INVESTING ACTIVITIES	(43,739)	(2,555)
FINANCING ACTIVITIES		
Issuance of debt	12,000	31,819
Repayment of debt	(11,371)	(110,000)
Dividends paid	(31,667)	(62,545)
Proceeds from the issuance of common shares	546	2,027
Repurchase of common shares	(94)	(1,754)
Other	—	(678)
CASH USED FOR FINANCING ACTIVITIES	(30,586)	(141,131)
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(1,582)	13
CASH AND CASH EQUIVALENTS		
Change in cash and cash equivalents	(22,509)	(43,573)
Balance, beginning of year	161,558	199,644
Balance, end of period	$139,049	$156,071
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid during the period:		
Interest (a)	$5,016	$6,928
Income taxes	138	7,134

Non-cash investing activity:		
Capital assets purchased on account	2,441	17,891

(a) Interest paid is presented net of patronage refunds received of $1.3 million for the three months ended March 31, 2015 and $2.1 million for the three months ended March 31, 2014. For additional information on patronage refunds, see Note 13 — Debt in the 2014 Form 10-K.

See Notes to Consolidated Financial Statements.

RAYONIER INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(Dollar amounts in thousands unless otherwise stated)

1. BASIS OF PRESENTATION

Basis of Presentation

The unaudited consolidated financial statements and notes thereto of Rayonier Inc. and its subsidiaries (“Rayonier” or the “Company”) have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and in accordance with the rules and regulations of the Securities and Exchange Commission (the “SEC”). In the opinion of management, these financial statements and notes reflect all adjustments (all of which are normal recurring adjustments) necessary for a fair presentation of the results of operations, financial position and cash flows for the periods presented. These statements and notes should be read in conjunction with the financial statements and supplementary data included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014, as filed with the SEC (the “2014 Form 10-K”).

Reclassifications

Certain 2014 amounts have been reclassified to conform to the current presentation, including changes in balance sheet presentation. During the first quarter of 2015, the Company reclassified seeds and seedlings from Inventory and Other Assets to Timber and Timberlands, Net to better reflect the intended use of the assets. Rayonier also reclassified long-term higher and better use (“HBU”) timberlands and real estate development costs from Other Assets to a separate balance sheet caption. These adjustments are reflected in the March 31, 2015 and December 31, 2014 Consolidated Balance Sheets. Corresponding changes have also been made to the Consolidated Statements of Cash Flows for both periods presented.

Certain 2014 amounts have also been adjusted for reclassifications of discontinued operations. Rayonier completed the spin-off of its Performance Fibers business on June 27, 2014. Accordingly, the operating results of this business segment are reported as discontinued operations in the Company’s Consolidated Statements of Income and Comprehensive Income for the prior-year period. Certain administrative and general costs historically allocated to the Performance Fibers business that remained with Rayonier are reported in continuing operations.

The Consolidated Statement of Cash Flows for March 31, 2014 has not been restated to exclude Performance Fibers cash flows.

See Note 2 — Discontinued Operations for additional information regarding the spin-off of the Performance Fibers business.

New Accounting Standards

In May 2014, the Financial Accounting Standards Board (“FASB”) and International Accounting Standards Board (“IASB”) jointly issued Accounting Standards Update (“ASU”) No. 2014-09, Revenue from Contracts with Customers, a comprehensive new revenue recognition standard that will supersede current revenue recognition guidance. The core principle is that an entity will recognize revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to receive in exchange for those goods or services. The guidance provides a unified model to determine when and how revenue is recognized and will require enhanced disclosures regarding the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity’s contracts with customers. In April 2015, the FASB voted for a one-year deferral of the effective date of the new standard, with an option for organizations to adopt early based on the original effective date. If approved, this standard will be effective for Rayonier beginning January 1, 2018 and can be applied either retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. The Company is currently evaluating the impact of adopting this new guidance on the consolidated financial statements.

In February 2015, the FASB issued ASU No. 2015-02, Consolidation, which changes the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. This standard will be effective for Rayonier’s first quarter 2016 Form 10-Q filing and is not expected to have an impact on the Company’s consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-03, Interest — Imputation of Interest. This amendment requires that debt issuance costs be presented in the Balance Sheet as a direct deduction from the carrying amount of the debt liability. This standard will be effective for Rayonier's first quarter 2016 Form 10-Q filing and is not expected to have a material impact on the Company's consolidated financial statements.

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RAYONIER INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)
(Dollar amounts in thousands unless otherwise stated)

Subsequent Events
The Company evaluated events and transactions that occurred after the Balance Sheet date but before the financial statements were issued, and no subsequent events were identified.

2. DISCONTINUED OPERATIONS
Spin-Off of the Performance Fibers Business
On June 27, 2014, Rayonier completed the tax-free spin-off of its Performance Fibers business and retained its timber, real estate and trading businesses. The spin-off resulted in two independent, publicly-traded companies, with the Performance Fibers business being spun-off to Rayonier shareholders as a newly formed public company named Rayonier Advanced Materials Inc. (“Rayonier Advanced Materials”). On June 27, 2014, the shareholders of record received one share of Rayonier Advanced Materials common stock for every three common shares of Rayonier held as of the close of business on the record date of June 18, 2014.
In connection with the spin-off, Rayonier Advanced Materials distributed $906.2 million in cash to Rayonier from $550 million in Senior Notes issued by Rayonier A.M. Products (a wholly-owned subsidiary of Rayonier Advanced Materials), $325 million in term loans, and $75 million from a revolving credit facility Rayonier Advanced Materials entered into prior to the spin-off. Pursuant to the terms of the Internal Revenue Service spin-off ruling, $75 million of this cash was paid to Rayonier’s shareholders as dividends. Of this $75 million, $63.2 million was paid to shareholders as a special dividend in the third quarter of 2014.
In order to effect the spin-off and govern the Company’s relationship with Rayonier Advanced Materials after the spin-off, Rayonier and Rayonier Advanced Materials entered into a Separation and Distribution Agreement, an Intellectual Property Agreement, a Tax Sharing Agreement, an Employee Matters Agreement and a Transition Services Agreement. See Note 3 — Discontinued Operations in the 2014 Form 10-K for further details concerning these agreements.
Rayonier will not have significant continuing involvement in the operations of the Performance Fibers business going forward. Accordingly, the operating results of the Performance Fibers business, formerly disclosed as a separate reportable segment, are classified as discontinued operations in the Company's Consolidated Statements of Income and Comprehensive Income for all periods presented. Certain administrative and general costs historically allocated to the Performance Fibers segment are reported in continuing operations, as required.
The following table summarizes the operating results of the Company's discontinued operations related to the Performance Fibers spin-off for the three months ended March 31, 2014, as presented in "Income from discontinued operations, net" in the Consolidated Statements of Income and Comprehensive Income:

	Three Months Ended March 31, 2014	
Sales	$243,499	
Cost of sales and other	(193,864	)
Transaction expenses	(3,319	)
Income from discontinued operations before income taxes	46,316	
Income tax expense	(15,308	)
Income from discontinued operations, net	$31,008	

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RAYONIER INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)
(Dollar amounts in thousands unless otherwise stated)

In accordance with Accounting Standards Codification ("ASC") 205-20-S99-3, Allocation of Interest to Discontinued Operations, the Company elected to allocate interest expense to discontinued operations where the debt is not directly attributed to the Performance Fibers business. Interest expense has been allocated based on a ratio of net assets to be discontinued to the sum of consolidated net assets plus consolidated debt (other than debt directly attributable to the Timber and Real Estate operations). The following table summarizes the interest expense allocated to discontinued operations for the three months ended March 31, 2014:

	Three Months Ended March 31, 2014
Interest expense allocated to the Performance Fibers business	($2,295)

The following table summarizes the depreciation, amortization and capital expenditures of the Company's discontinued operations related to the Performance Fibers business:

	Three Months Ended March 31, 2014
Depreciation and amortization	$20,649
Capital expenditures	17,876

Pursuant to a Memorandum of Understanding agreement, Rayonier may provide Rayonier Advanced Materials with up to 120,000 tons of hardwood annually through July 30, 2017. Prior to the spin-off, hardwood purchases were intercompany transactions eliminated in consolidation as follows:

	Three Months Ended March 31, 2014
Hardwood purchases	$2,745

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RAYONIER INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)
(Dollar amounts in thousands unless otherwise stated)

3. EARNINGS PER COMMON SHARE

The following table provides details of the calculations of basic and diluted earnings per common share:

	Three Months Ended March 31,	
	2015	2014
Income from continuing operations	$18,180	$10,335
Less: Net income (loss) from continuing operations attributable to noncontrolling interest	433	(83)
Income from continuing operations attributable to Rayonier Inc.	$17,747	$10,418
Income from discontinued operations, net, attributable to Rayonier Inc.	—	31,008
Net income attributable to Rayonier Inc.	$17,747	$41,426
Shares used for determining basic earnings per common share	126,614,334	126,344,987
Dilutive effect of:		
Stock options	168,680	286,535
Performance and restricted shares	51,494	83,850
Assumed conversion of Senior Exchangeable Notes (a)	892,885	1,063,538
Assumed conversion of warrants (a)	—	645,583
Shares used for determining diluted earnings per common share	127,727,393	128,424,493
Basic earnings per common share attributable to Rayonier Inc.:		
Continuing operations	$0.14	$0.08
Discontinued operations	—	0.25
Net income	$0.14	$0.33
Diluted earnings per common share attributable to Rayonier Inc.:		
Continuing operations	$0.14	$0.08
Discontinued operations	—	0.24
Net income	$0.14	$0.32

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RAYONIER INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)
(Dollar amounts in thousands unless otherwise stated)

	Three Months Ended March 31,	
	2015	2014
Anti-dilutive shares excluded from the computations of diluted earnings per share:		
Stock options, performance and restricted shares	757,960	731,046
Assumed conversion of exchangeable note hedges (a)	892,885	1,063,538
Total	1,650,845	1,794,584

(a) Rayonier will not issue additional shares upon future exchange or maturity of the Senior Exchangeable Notes due 2015 (the "2015 Notes") due to offsetting hedges. ASC 260, Earnings Per Share requires the assumed conversion of the 2015 Notes to be included in dilutive shares if the average stock price for the period exceeds the strike price, while the assumed conversion of the hedges is excluded since they are anti-dilutive. The full dilutive effect of the 2015 Notes was included for all periods presented.

Rayonier will distribute additional shares upon maturity of the warrants sold in conjunction with the 2015 Notes if the stock price exceeds $28.12 per share. The exchange price on the warrants is lower than periods prior to second quarter 2014 as it has been adjusted to reflect the spin-off of the Performance Fibers business. The warrants were not dilutive for the three months ended March 31, 2015 as the average stock price for the period did not exceed the strike price. For further information, see Note 13 — Debt in the 2014 Form 10-K and Note 15 — Debt of this Form 10-Q.

4. INCOME TAXES

The operations conducted by the Company's Real Estate Investment Trust ("REIT") entities are generally not subject to U.S. federal and state income taxation. Non-REIT qualifying operations are conducted by the Company's taxable REIT subsidiaries. Prior to the June 27, 2014 spin-off of Rayonier Advanced Materials, the Company's taxable REIT subsidiaries ("TRS") operations included the Performance Fibers business. As such, during 2014 and prior periods the income tax benefit from continuing operations was significantly impacted by the TRS businesses. Subsequent to the spin-off, the primary businesses performed in Rayonier's taxable REIT subsidiaries include log trading and certain real estate activities, such as the sale and entitlement of development HBU properties.

Provision for Income Taxes from Continuing Operations

The Company's effective tax rate is below the 35 percent U.S. statutory rate due to tax benefits associated with being a REIT. The income tax benefit for the three months ended March 31, 2015 is principally related to the Matariki Forestry Group joint venture (the "New Zealand JV"). The prior year period's benefit was due to losses at Rayonier's taxable operations primarily from interest and general administrative expenses not allowed to be allocated to the discontinued operations of the Performance Fibers business and is not comparable to the current year.

The table below reconciles the U.S. statutory rate to the Company's effective tax rate for each period presented:

	Three Months Ended March 31,							
	2015				2014			
Income tax expense at federal statutory rate	($6,198	)	35.0	%	($959	)	35.0	%
REIT income and taxable losses	7,502		(42.4	)	7,188		(262.4	)
Foreign operations	1,137		(6.4	)	(10	)	0.4	
Net operating loss valuation allowance	(1,812	)	10.2		—		—	
Other	(158	)	0.9		7		(0.3	)
Income tax benefit before discrete items	$471		(2.7	)%	$6,226		(227.3	)%
Prior period state tax adjustments	—		—		1,370		(50.0	)

Income tax benefit as reported for continuing operations	$471	(2.7)%	$7,596	(277.3)%

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RAYONIER INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)
(Dollar amounts in thousands unless otherwise stated)

Provision for Income Taxes from Discontinued Operations
On June 27, 2014, Rayonier completed the spin-off of its Performance Fibers business. For the three months ended March 31, 2014, income tax expense related to Performance Fibers discontinued operations was $15.3 million. See Note 2 — Discontinued Operations for additional information on the spin-off of the Performance Fibers business.

5. HIGHER AND BETTER USE TIMBERLANDS AND REAL ESTATE DEVELOPMENT COSTS

Rayonier continuously assesses potential alternative uses of its timberlands, as some properties may become more valuable for development, residential, recreation or other purposes. The Company periodically transfers, via a sale or contribution from the REIT to TRS, HBU timberlands to enable land-use entitlement, development or marketing activities. The Company also acquires HBU properties in connection with timberland acquisitions. These properties are still managed as timberlands until sold or developed. While the majority of HBU sales involve rural and recreational land, the Company also selectively pursues various land-use entitlements on certain properties for residential, commercial and industrial development in order to enhance the long-term value of such properties. For selected development properties, Rayonier also invests in targeted infrastructure improvements, such as roadways and utilities, to accelerate the marketability and improve the value of such properties.
An analysis of higher and better use timberlands and real estate development costs from December 31, 2014 to March 31, 2015 is shown below:

	Higher and Better Use Timberlands and Real Estate Development Costs		
	Land and Timber	Development Costs	Total
Non-current portion at December 31, 2014	$65,959	$11,474	$77,433
Plus: Current portion (a)	4,875	57	4,932
Total Balance at December 31, 2014	70,834	11,531	82,365
Non-cash cost of land sold and real estate development costs recovered upon sale	(3,669)	(4)	(3,673)
Timber depletion from harvesting activities	(554)	—	(554)
Capitalized real estate development costs (b)	—	276	276
Capital expenditures (silviculture)	49	—	49
Acquisitions	—	—	—
Transfers	—	—	—
Total Balance at March 31, 2015	66,660	11,803	78,463
Less: Current portion (a)	(6,173)	(338)	(6,511)
Non-current portion at March 31, 2015	$60,487	$11,465	$71,952

(a) The current portion of Higher and Better Use Timberlands and Real Estate Development Costs is recorded in Inventory. See Note 14 — Inventory for additional information.
(b) Capitalized real estate development costs for the three months ended March 31, 2015 of $276,000 consisted of $306,000 in cash outflows and a $30,000 change in accrued spending.

6. RESTRICTED DEPOSITS

In order to qualify for like-kind exchange (“LKE”) treatment, the proceeds from real estate sales must be deposited with a third-party intermediary. These proceeds are accounted for as restricted cash until a suitable replacement property is acquired. In the event LKE purchases are not completed, the proceeds are returned to the Company after 180 days and reclassified as available cash. As of March 31, 2015 and December 31, 2014, the Company had $13.8 million and $6.7 million, respectively, of proceeds from real estate sales classified as restricted cash in Other Assets, which were deposited with an LKE intermediary.

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RAYONIER INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)
(Dollar amounts in thousands unless otherwise stated)

7. SHAREHOLDERS' EQUITY

An analysis of shareholders' equity for the three months ended March 31, 2015 and the year ended December 31, 2014 is shown below (share amounts not in thousands):

	Rayonier Inc. Shareholders' Equity					
	Common Shares					
	Shares (a)	Amount	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Non-controlling Interest	Total Shareholders' Equity
Balance, December 31, 2013	126,257,870	$692,100	$1,015,209	($46,139)	$94,073	$1,755,243
Net income (loss)	—	—	99,337	—	(1,491)	97,846
Dividends ($2.03 per share)	—	—	(256,861)	—	—	(256,861)
Contribution to Rayonier Advanced Materials	—	(301)	(61,318)	80,749	—	19,130
Adjustments to Rayonier Advanced Materials (b)	—	—	(5,670)	(2,556)	—	(8,226)
Issuance of shares under incentive stock plans	561,701	5,579	—	—	—	5,579
Stock-based compensation	—	7,869	—	—	—	7,869
Tax deficiency on stock-based compensation	—	(791)	—	—	—	(791)
Repurchase of common shares	(46,474)	(1,858)	—	—	—	(1,858)
Net loss from pension and postretirement plans	—	—	—	(24,147)	—	(24,147)
Noncontrolling interest redemption of shares	—	—	—	—	(931)	(931)
Foreign currency translation adjustment	—	—	—	(11,526)	(4,321)	(15,847)
Joint venture cash flow hedges	—	—	—	(1,206)	(649)	(1,855)
Balance, December 31, 2014	126,773,097	$702,598	$790,697	($4,825)	$86,681	$1,575,151
Net income	—	—	17,747	—	433	18,180
Dividends ($0.25 per share)	—	—	(31,617)	—	—	(31,617)
Issuance of shares under incentive stock plans	32,196	546	—	—	—	546
Stock-based compensation	—	805	—	—	—	805
Tax deficiency on stock-based compensation	—	(267)	—	—	—	(267)
Repurchase of common shares	(2,984)	(94)	—	—	—	(94)
Net gain from pension and postretirement plans	—	—	—	781	—	781
Foreign currency translation adjustment	—	—	—	(10,429)	(3,894)	(14,323)
Joint venture cash flow hedges	—	—	—	(615)	(331)	(946)
Balance, March 31, 2015	126,802,309	$703,588	$776,827	($15,088)	$82,889	$1,548,216

(a) The Company’s common shares are registered in North Carolina and have a $0.00 par value.

(b) Primarily relates to adjustments made to the Rayonier Advanced Materials contribution as income taxes and pension and postretirement plan assets and obligations were finalized.

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RAYONIER INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)
(Dollar amounts in thousands unless otherwise stated)

8. SEGMENT AND GEOGRAPHICAL INFORMATION

On June 27, 2014, the Company spun-off its Performance Fibers business and its operations are shown as discontinued operations for all periods presented. See Note 2 — Discontinued Operations for additional information. Effective with the fourth quarter of 2014, the Company realigned its segments considering the economic characteristics of each business unit and the way management now internally evaluates business performance and makes capital allocation decisions. All prior period amounts have been reclassified to reflect the newly realigned segment structure. See Item 2 — Management's Discussion and Analysis of Financial Condition and Results of Operations — Our Company for additional information.

Sales between operating segments are made based on estimated fair market value, and intercompany sales, purchases and profits (losses) are eliminated in consolidation. The Company evaluates financial performance based on segment operating income and Adjusted EBITDA. Asset information is not reported by segment, as the company does not produce asset information by segment internally.

Operating income as presented in the Consolidated Statements of Income and Comprehensive Income is equal to segment income. Certain income (loss) items in the Consolidated Statements of Income and Comprehensive Income are not allocated to segments. These items, which include gains (losses) from certain asset dispositions, interest income (expense), miscellaneous income (expense) and income tax (expense) benefit, are not considered by management to be part of segment operations.

Segment information for each of the three months ended March 31, 2015 and 2014 were as follows:

	Three Months Ended March 31,	
SALES	2015	2014
Southern Timber	$35,531	$33,876
Pacific Northwest Timber	19,154	33,038
New Zealand Timber	41,194	37,764
Real Estate	23,791	5,530
Trading	20,635	35,686
Intersegment Eliminations	—	(2,707)
Total	$140,305	$143,187

	Three Months Ended March 31,	
OPERATING INCOME	2015	2014
Southern Timber	$12,413	$10,493
Pacific Northwest Timber	2,587	12,642
New Zealand Timber	5,694	2,411
Real Estate	12,582	725
Trading	270	(412)
Corporate and other	(5,799)	(11,434)
Total Operating Income	27,747	14,425
Unallocated interest expense and other	(10,038)	(11,686)
Total income from continuing operations before income taxes	$17,709	$2,739

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RAYONIER INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)
(Dollar amounts in thousands unless otherwise stated)

	Three Months Ended March 31,	
DEPRECIATION, DEPLETION AND AMORTIZATION	2015	2014
Southern Timber	$14,301	$11,996
Pacific Northwest Timber	3,790	6,297
New Zealand Timber	8,003	6,496
Real Estate	3,812	910
Trading	—	—
Corporate and other	69	282
Total	$29,975	$25,981