

A Reprint from *Tierra Grande*

LAND WHOA!

HOT MARKETS COOL

By Charles E. Gilliland

Land markets tend to change with a whimper, not a bang. The typical dynamic is a dwindling activity level with weakly rising prices as buyers concentrate on fewer high-quality properties, leaving the more ordinary offerings to languish.

Initial 2008 Texas sales reports revealed that those conditions held true in many areas of the state. Overall, land prices continued to rise through the first half of the year even as the number of transactions declined. In a quarter-to-quarter comparison, however, second quarter prices failed to exceed 2007 second quarter prices, and the rate of increase in year-to-date price comparisons slowed from 14 percent in the first quarter to 8 percent over the first half of the year.

Volume of sales lagged 31 percent behind 2007 levels. Land market professionals report the number of ranchland sales dropped 30 percent or more with commercial land sales in some urban areas falling by even larger margins.

In addition, they report buyer resistance to current asking prices with some sellers completing sales only after price reductions. Some sellers are having no luck despite marking prices down. Still, median prices are rising in many locales across the state.

Traditionally, uncertainty in financial and investment markets compels people to seek a safe haven for their capital. Tangible assets have long been a preferred vehicle, so worried investors may gravitate toward land in the current environment, just as they did after 9/11.

However, some of those buyers are beginning to suspect that they are buying in at the top of the market. Owners who harbor similar judgments about future land prices have listed their holdings at today's high prices.

Given past market dynamics, these market participants' concerns may be well founded. In the 40-year history of the Center's land market research, overall prices have tracked personal income closely. A recession that stalls or reverses Texas personal income poses a threat to land prices.

True, Texas is performing much better than the rest of the nation, and personal income is still expanding. But danger lies ahead. If the national recession drags Texas into its vortex of declining activity, land markets probably cannot avoid the painful realities already playing out in the residential market. The extent of the exposure lies partly in the financial strength of current owners.

In the 1980s, the broad use of leverage made owners vulnerable to an economic downturn. Leveraged buyers defaulted on loans, and new buyers abandoned the markets. Land flooded into acquired property inventories at various financial institutions, and the rest is history. Prices dropped 30 percent from 1985 through 1987 and continued their lackluster performance for five more years, causing another 12 percent decline.

Conventional wisdom holds that today's buyers are using much less leverage, perhaps indicating that they are less apt to abandon their land. However, no reliable statistics exist to document the amount of leverage supporting current Texas land markets. One thing is certain: various farm credit associations and a number of commercial banks have been active in

the markets. Someone must have been borrowing those funds.

Ultimately, these factors have created an atmosphere more fraught with risk for land buyers than at any time in the past decade. The significant economic downturn suggests that at best prices may stagnate and at worst lose the remarkable gains made in the past few years. Analysis indicates that current land prices may be as much as 30 percent greater than the level suggested by extending the trend established during the 1992 to 2003 recovery.

It has been evident for quite some time that the unprecedented 17 percent annual appreciation rate in Texas land markets from 2002 to 2007 cannot continue. Sales may halt or dwindle to a trickle with moderating or sliding prices.

Funds invested in land may become stranded if owners are unwilling to drop asking prices should this economic malaise maintain its grip for an extended period. Owners cannot expect to be able to extract their capital should they need funds for other investments and activities.

The potential for a long-term correction in land markets has increased substantially with the chaos in financial markets. Such a correction could eventually translate into stable or declining land values on a widespread basis. ➤

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THE TAKEAWAY

The general decline in economic activity in the aftermath of the financial meltdown threatens Texas land markets in 2009. Market observers predict sales volume will diminish and prices will stagnate in the short term.



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