

# FLAT LAND

By Charles E. Gilliland, Abhijeet Gunadekar and Siddhartha Singh

Land market professionals anticipate that the escalating uncertainty in the economy will lead to a market in which deals are simply not occurring. Lending standards have tightened, and owner financing has begun to emerge as a stopgap method of facilitating sales.

The year began with an undercurrent of fear. Some lenders appear to be reducing the volume of real estate related loans in their portfolios as they expect tough questioning from examiners and possible reductions in real estate values. In some markets, buyers are negotiating to buy loans on commercial land at substantial discounts from face value.



As job creation in Texas declines, potential buyers and sellers are increasingly at an impasse. Observers in many regional markets report a lack of activity after August 2008. Sensing the disquiet across the market, buyers have reduced bids to levels not acceptable to sellers. Sellers who initially held fast to their asking prices have begun to modestly reduce those prices in many areas.

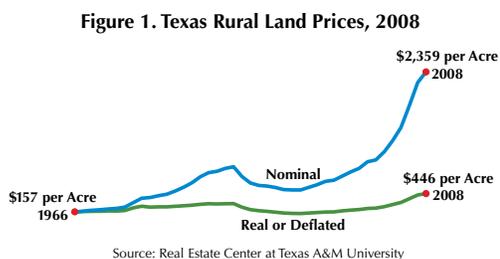
Although the land investments of many sellers appear to be financially sound, businesses supporting those investments may falter if the Texas economy retreats as many fear it will. Protecting those businesses may necessitate liquidating land holdings, which could motivate sellers to reduce prices. This could create a market populated by buyers with cash and distressed sellers needing that cash. These circumstances would likely initiate a downward price adjustment.

Farmland markets soared in the first half of 2008 and continued to thrive even after commodity prices retreated at midyear. Recent sales point to much slower growth in prices as farmers insist on earning a 4.5 to 5 percent return on their land. Currently, drought and low milk prices are plaguing some local markets. Midwest farmland prices have reportedly begun to drop. However, Texas farmland sales still were thriving in the spring of 2009.

## 2008 Land Prices

The 2008 five-year return on land dropped to 16.5 percent, down from 17.6 percent the year before. Reported sales data indicate that Texas land prices continued an upward trend (Figure 1), but at a much slower pace than from 2002 to 2007, when the annual compound growth rate was 17.6 percent.

The 2008 price was just 8 percent higher than the 2007 year-end overall price, rising from \$2,186 to \$2,359 per acre. Fading



growth percentages reflected softening demand as the year progressed.

The 2008 second-quarter median price failed to exceed the second-quarter 2007 median price. That marked the first time a quarterly median has fallen short of the corresponding quarterly price in many years. The change in median price from 2007 to 2008 was not statistically significant, suggesting that the increase may not have occurred in all categories of land.

The real or inflation-adjusted price of \$446 per acre in 1966 dollars pushed past the 2007 record level of \$423, marking a 5 percent real increase over the 2007 annual price. Nominal prices reflect the actual prices paid while real prices represent those nominal prices adjusted for inflation (Figure 1).

## Tract Size, Sales Volume

The typical Texas tract size increased to 90 acres in 2008 (Figure 2), up from the historic low of 80 acres in 2007. Markets had hovered in the 100-acre range from 2000 through 2006, but the 2007 median size seemed to indicate a market focused on smaller sales. The 90-acre 2008 median marked a rebound, back toward longer-term averages.

Sales volume dropped in 2008 with 5,893 transactions reported during the year, approximating 2002 volume levels (Figure 3). The 2007 volume of 7,349 was more than 20 percent higher than 2008 activity.

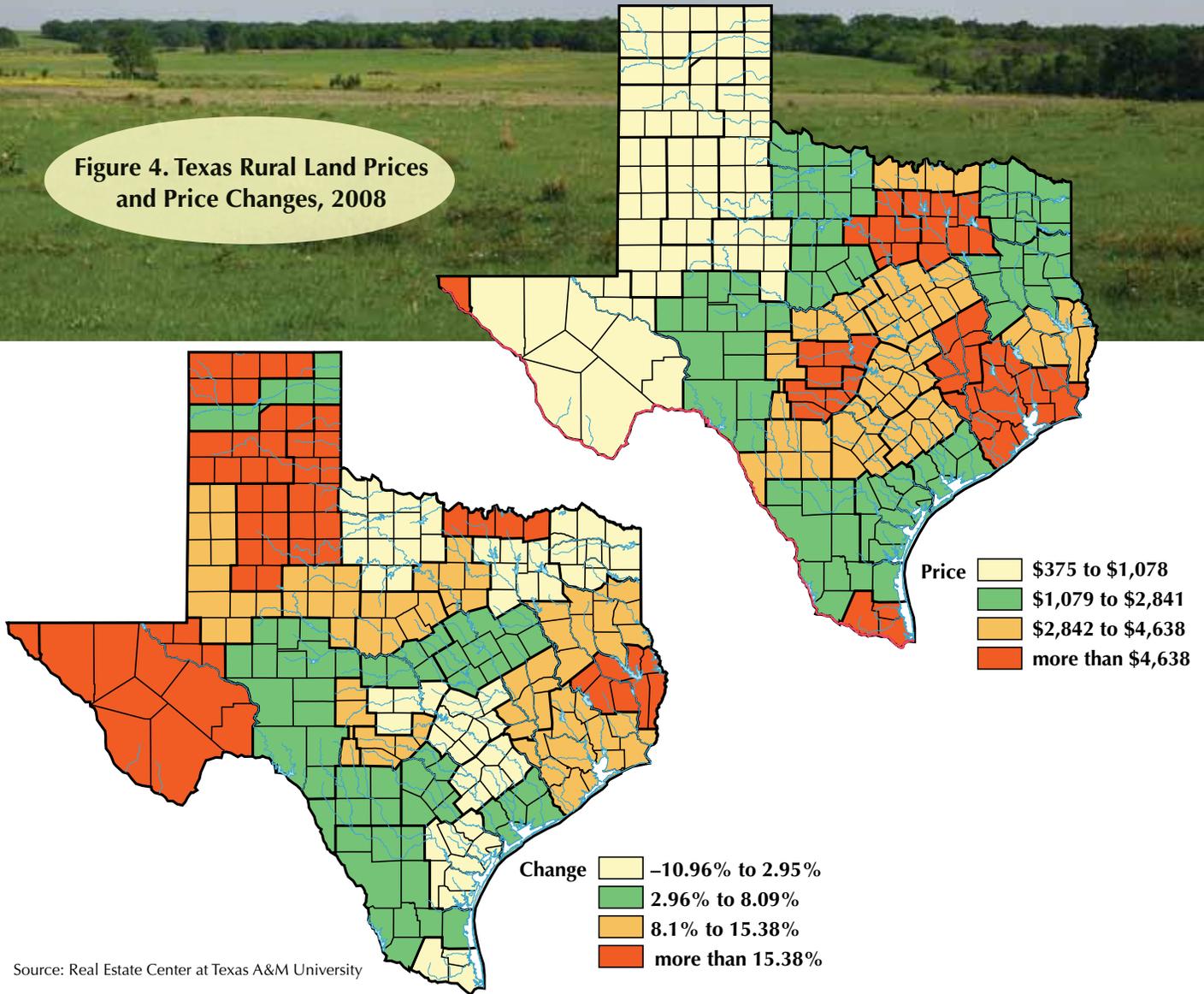
## Tomorrow's Forecast

Economic uncertainty drives investors to seek out safe havens to preserve their wealth. Tangible assets such as real estate have historically served as sound investment vehicles in troubled times. Market participants report continued interest from investors who see Texas land prices as bargains compared

**Figure 2. Texas Typical Tract Size**



Figure 4. Texas Rural Land Prices and Price Changes, 2008



Source: Real Estate Center at Texas A&M University

with other areas of the country (Figure 4). All of this points to markets with decidedly different future trends.

Commercial land prospects look bleak. Prices could fall substantially. Farmland, though less sanguine than in the heady days of soaring commodity prices, still enjoys steady demand. Recreational tracts face an uncertain future. These conditions make it unlikely that overall Texas

rural land prices will continue to climb even at 2008 levels.

Markets participants are split in their forecasts.

Many anticipate a flat market in the year ahead. Others fear a potential decline as the reality of the downturn overtakes the previously robust Texas economy. 📍

Dr. Gilliland (c-gilliland@tamu.edu) is a research economist and Gunadekar and Singh are research assistants with the Real Estate Center at Texas A&M University.

Figure 3. Texas Land Market Volume, 2008



Source: Real Estate Center at Texas A&M University

## THE TAKEAWAY

Land prices rose in 2008 but not as steeply as in the past few years. Economic uncertainty at the national level is beginning to take its toll on Texas land markets. Some market observers anticipate flat sales while others predict a decline.



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Texas A&M University  
2115 TAMU  
College Station, TX 77843-2115

<http://recenter.tamu.edu>  
979-845-2031

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