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# Buying Rural Land

By Charles E. Gilliland

**M**any potential buyers find the process of purchasing rural land inherently stressful. Generally, such purchases represent a substantial investment; mistakes are especially costly. Inexperienced buyers may be unaware of possible pitfalls. Because of the underlying financial risks, they may be wise to engage an experienced real estate agent for assistance. In addition, some basic guidelines are useful.

Land buying involves four phases:

- locating the property,
- identifying desired land characteristics and property rights,
- valuing the property and
- completing the transaction.

## Focus on Specific Locations

Often cited as the most important attribute of real estate, location identifies the physical features of the property and defines its specific characteristics within the context of surrounding properties. More than any other single influence, location defines the potential uses of a property.

Locating a property begins with a list of specific property attributes sought by the buyer. Buyers should clearly define the major land uses they envision.

How far are they willing to drive to the property? How close should it be to a town? The distance issue also is affected by accessibility. Does the property have frontage on a paved road? Are buyers willing to sacrifice easy access

for solitude and scenic beauty? Do they want access to a rural water supply system or are they willing to drill a well? The answers focus the search on specific locations.

The location decision involves geographic attributes. If buyers seek rugged Hill Country beauty with abundant wildlife, they will focus on Central Texas. Conversely, if they desire an attractive recreational site with easy access, a nearby ranch may fit their needs. For investment buyers, the path of progress determines location.

## Identify Essential Features

Next, potential buyers should identify the essential features in their desired property. Do they want trees? Is a running creek a must? How much land is enough? Frequently buyers find that they have acquired too little or too much land to effectively accomplish their desired use. An honest appraisal of needs helps the buyer avoid inappropriate investments.

Often the size question depends on how much the buyer can afford to spend on land. Competing buyers and sellers have set a typical price per acre in the market, and the amount potential buyers can afford depends on their budgets. Other attributes being equal, distance from urban areas plays a determining role in land prices. For example, the closer the tract lies to San Antonio the

higher the price per acre and the smaller the property many potential buyers can afford.

If a buyer needs a certain amount of land, for example 600 acres for a hunting property in the Hill Country, then typical price per acre becomes a critical issue. Price can determine size, or size can determine location. To clearly evaluate this size-distance tradeoff, potential buyers must know how much they can afford to spend. The general levels of land prices in various Texas areas are available in the Real Estate Center land value reports. These reports are published periodically, and the basic information is available at the Center's internet site (<http://recenter.tamu.edu>).

## Understand Property Rights

Property characteristics define potential physical uses while property rights define legal ownership. Combined, the two create a market value for the land. A clear understanding of these influences assists in price negotiations.

Potential buyers should identify both physical attributes and detractions. Potential buyers should view the property as if they eventually intend to sell it. If an attribute repels potential buyers, the impact should be considered for future negotiations.

Property rights are less tangible and encompass issues from verifying ownership to identifying easements. Because they specify the potential legal uses of the land, available property rights may be more important than physical features. If the structure of ownership prohibits a highly prized use, that defect will exert an impact on the value. For example, an attractive ranch with a pipeline easement through its center is less appealing than one without it. Until the property rights issue has been addressed, potential buyers have little basis for estimating a reasonable price.

**S**ome significant property rights issues include: existing lease provisions, undivided interests, mineral rights ownership, restrictive covenants, environmental regulations for endangered species, hazardous substances or wetlands, historical preservation regulations and property taxes.

**Lease provisions.** Initially a grazing or farming lease may seem insignificant. Most agricultural leases run for a short period; many are renewed annually. However, lease provisions may exert a decided influence on the purchase process. The right-of-first-refusal, often granted to long-term tenants, can complicate matters for a buyer. Specifically, the potential buyer invests time and effort in negotiating the best price possible only to see the tenant step in to purchase the land. Potential buyers may avoid negotiating for properties with a right-of-first-refusal.

**Undivided interest.** Another difficulty can arise when several individuals own undivided interests in the land, such as heirs to a family ranch or farm. Although it does not automatically guarantee problems, undivided interests complicate the negotiation process when all owners do not wish to sell. Purchasing such property may present a negotiating challenge. All owners must be committed to a sale.

Purchase of an undivided interest from one owner is possible, followed by action to partition the land. However, the value of a partial land interest is likely to be less than full ownership of only part of the land. For example, a buyer would likely pay less per acre for a 50 percent interest in a 100-acre tract than for full ownership of 50 acres.

**Mineral rights.** Mineral ownership can be important for land buyers, especially when less than half of the minerals transfer with ownership. Mineral owners dominate surface owners. This means that a mineral owner, or the lessee, can enter the property to extract the minerals

without obtaining permission from the landowner. Thus, if minerals belong to another person, a landowner has little control over oil and gas drilling. Furthermore, if the current owner has executed a lease with a producer, that lease remains in force even if the minerals transfer with the surface.

Mineral rights have been a fixture in the Texas land market for many years and do not doom a sale. However, a potential buyer should not purchase property without inquiring about the possibility of mineral exploration.

**Restrictive covenants.** Some land titles contain restrictive covenants that constrain use. Restrictive covenants are sometimes called *deed restrictions*, and they typically attempt to ensure a particular level of land use. A commonly encountered deed restriction requires an owner to build a home with a specified minimum area. Restrictive covenants have an effect similar to zoning. However, enforcement of restrictive covenants for rural land generally depends on legal action by individuals rather than on government enforcement.

Most problems with restrictive covenants occur when a buyer is uninformed. The solution lies in identifying possible restrictions before completing the transaction. Then both buyer and seller can take the restrictions into account.

**“Potential buyers should inquire about the possibility of mineral exploration.”**

**Environmental regulations.** Environmental regulations may signal potential problems for landowners. Consequently, buyers should identify possible issues prior to closing. Like restrictive covenants, endangered species regulations or the presence of wetlands can limit land uses. The presence of hazardous substances may create an onerous liability for anyone taking title to land. The Real Estate Center has several publications on such issues.

Known endangered species are protected under federal law, including required preservation of their habitat. Owners of land harboring an endangered animal likely will find severe restrictions

on land use. In some cases, restrictions have halted most human activity in endangered species habitat.

No one can predict whether a particular property may become the home of an endangered species as more endangered plants and animals are identified. However, the buyer's awareness of existing endangered species habitat and of the identity of threatened species that may acquire endangered status is helpful.

**Historic preservation regulations.** Like environmental regulations, historic preservation regulations can affect owners of historical sites. When a land sale includes a historical structure, owners often regard the site with pride. However, buyers may find historic preservation restrictions troublesome. Historical sites need not prevent a transaction if buyers know the implications before purchase and negotiate price accordingly.

**Property taxes.** Another potential stumbling block for land buyers that could affect price negotiations is the appraisal method used to determine taxes. If the current owner has been taxed under the Texas open-space provision, the liability for a potential rollback tax passes to the new owner.

Open-space treatment depends on establishing a record of past and continuing land use for agriculture or timber production. Providing wildlife habitat qualifies as an agricultural use under certain conditions. When the land receives open-space treatment, property tax liability depends on agricultural use value rather than market value. Often, open-space status results in a substantial tax reduction. However, when land use changes, the *Texas Property Tax Code* imposes an additional tax equal to the difference between taxes based on market value and taxes based on use value for the past five years. It also imposes a liability for interest on the rollback taxes.

Frequently, open-space tax treatment creates no difficulties, but potential problems emerge when the seller has benefited from reduced taxes and a buyer adopts a nonqualifying land use soon after purchase. Changing the use triggers the rollback and imposes a tax lien on the land for the rollback tax plus interest. Despite the seller's receiving the benefit, the land buyer typically assumes this added tax burden.

This situation may generate law suits between buyers and former owners. Buyers point to the reduced tax enjoyed by the seller for the years preceding the change. Sellers contend that they have

no control over a buyer's land-use decisions and did not anticipate the change to a nonqualifying use. After litigation, the owner still must pay the rollback tax to clear the land title. If open-space rollback taxes are a potential outcome of the purchase, buyers should resolve the issue during negotiations.

### Valuing the Property

**V**aluing land is a specialized activity requiring knowledge of local markets and the influence of property features on prices. Landowners know about the positive features of their land and usually hope to receive more than top dollar. Land buyers may have little access to information about local prices. The specific price essentially summarizes a property's current condition and its future value in a competitive market.

Land price reports may assist buyers as they begin to formulate an offering price. However, these reports reflect general market conditions rather than particular farms or ranches. Buyers negotiating in unfamiliar markets may find an informed real estate professional's assistance valuable.

### Completing the Transaction

After negotiating a price, a land purchase normally culminates in a contract. Typically, the buyer commits to buy and the seller promises to provide a deed, indicating a satisfactory transaction. However, all deeds are not equal, and some apparent sales are not sales. For example, a young couple wanted a particular tract and inquired about the property of a nearby homeowner. The homeowner offered to provide a deed for a cash payment. The couple paid the cash, and the homeowner delivered the deed.

The buyers, however, discovered that their deed was a *quit claim deed* instead of the more familiar *warranty deed*. The quit claim deed simply stipulates that the person providing the deed relinquishes any claim to the property in favor of the person receiving the deed. It does not guarantee or warrant that the



*Land buyers may have little access to information about local prices.*

person executing the deed even had a claim to the property. Had the homeowner owned the tract of land, title would have passed with the quit claim deed. However, in this case, the homeowner did not own an interest in the property, and the deed conveyed nothing.

Buyers frequently enter a transaction through a *land contract* or *contract for deed*. These documents typically obligate the land owner to give the buyer a deed after a specified number of payments. These documents essentially represent installment sales contracts and normally include interest payments. They also provide for cancellation of the seller's obligation if the buyer defaults on scheduled payments. When that occurs, the buyer has no claim on the land, and the owner can sell it to another party.

A land contract is a legal way to provide owner financing. Difficulties arise when buyers mistakenly believe that they have purchased the land. However, they will receive a deed only when they have made all payments. This detail was

pivotal in the 1980s when homebuyers purchased houses from a certain builder on a land contract. They paid the builder who had borrowed against the homes. The home sales market collapsed, and the builder ceased to pay the lender holding a lien on the houses. The homebuyers believed that they were making mortgage payments until the real mortgage company foreclosed on the homes.

These difficulties by no means represent all problems for land buyers. Buyers unfamiliar with different properties in their target area, property values and different legal documents should avoid completing a transaction without competent assistance. Because land investment represents a substantial financial commitment, buyers should reduce risk by gathering facts and seeking assistance from competent legal and real estate professionals, preferably those who specialize in rural land. □

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