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# Rural Land Outlook

By Charles E. Gilliland and M.A. Anari

**B**oyed by strong demand from recreational and residential users, Texas rural land markets marked the seventh straight year of recovery in 2000. Propelled by rising income levels, land price trends accelerated upward to levels last seen in the first half of the 1980s (see Graph 1).

After adjusting for inflation, the real price of an acre of Texas land exceeded the 1987 price level, and nothing short of prolonged recession in the general economy threatens to derail this progress. In fact, the latest inflation-adjusted price falls well short of the 1984 peak, suggesting that markets may support continuing price increases as willing buyers scramble to purchase increasingly scarce rural properties.

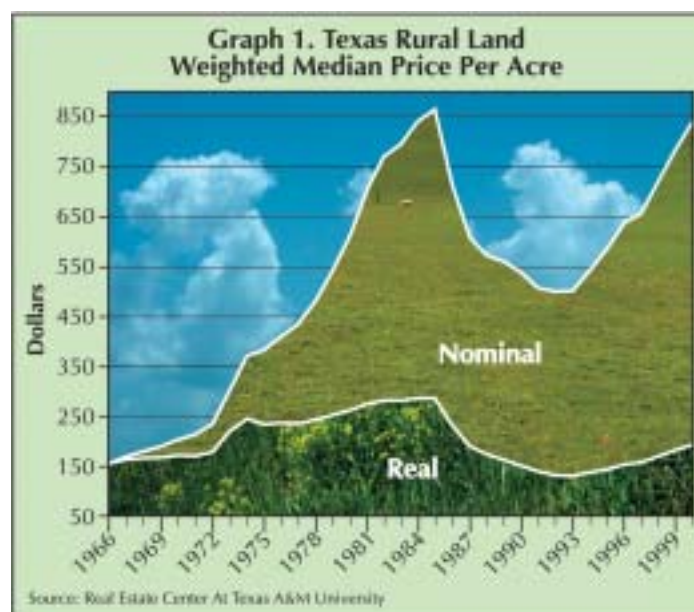
The market seems poised to welcome back investment buyers who abandoned land after the 1986–87 price collapse. With the exception of some development tracts near growing cities, investors have generally focused on nonland invest-

ments since that time. The continuing price recovery may lead investors to view land as an attractive option once more, which would further strengthen land prices.

As nominal land prices approach heady 1980s levels, however, some observers worry that the market cannot sustain further improvement. Investors should consider the economic elements driving current land markets. These include an expanding population, job growth and higher incomes. Adjusting for changes in purchasing power reveals that the 2000 real price of \$193 per acre falls short of the 35-year average of \$200 per acre ending in 2000. An increasing appetite for land driven by higher personal incomes, combined with historically low real prices creates the potential for higher prices.

## Investment Returns on Texas Land

Graph 2 shows the investment yields for short-term



**MANY RANCH OWNERS** are splitting their large properties into smaller parcels to maximize return.



depending on timing of purchase and sale.

The largest gains anticipated the rapid growth in land prices in the mid-1970s, early 1980s and 1990s. Land prices in each of these periods reflected times of prosperity driven by increasing incomes and a growing population. In the mid-1970s, land prices were fueled by the energy boom and strong agricultural profits.

During the early 1980s, energy prices poured purchasing power into the economy. In the 1990s, land prices became less dependent on the fortunes of agriculture and energy, as general prosperity sparked an influx of nontraditional buyers to the Texas land

(three-year), middle-term (five-year) and long-term (ten-year) holding periods in Texas rural land as measured by the weighted median price per acre. The gains shown reflect the annual compound rate of growth in land prices after deducting for inflation using the implicit price deflator for gross domestic product.

The yields do not include returns from agricultural or recreational activities nor do they reflect sales expenses or taxes. A positive return indicates that the rate of increase in land value exceeded the rate of inflation. The year on the graph is the year of acquisition.

Because of the long period of negative returns during the 1980s and early 1990s, the short-term (average 0.6 percent) and middle-term (average 0.3 percent) investment strategies produced average yields barely exceeding inflation. The long-term strategy (average -0.6 percent) failed to outpace inflation. The land market offered opportunities for substantial real gains,

market. The record-setting economic expansion of the 1990s may be drawing to a close or may simply be in a lull.

### Market Projections

In recent years, land market observers noted numerous purchases supported by stock market profits and made by beneficiaries of the booming high-tech sector. Now that the frenzied high-tech run-up has cooled, these observers anticipate a slackening in demand. Recent purchasers who depend on stock market profits for payments may be forced to liquidate land assets.

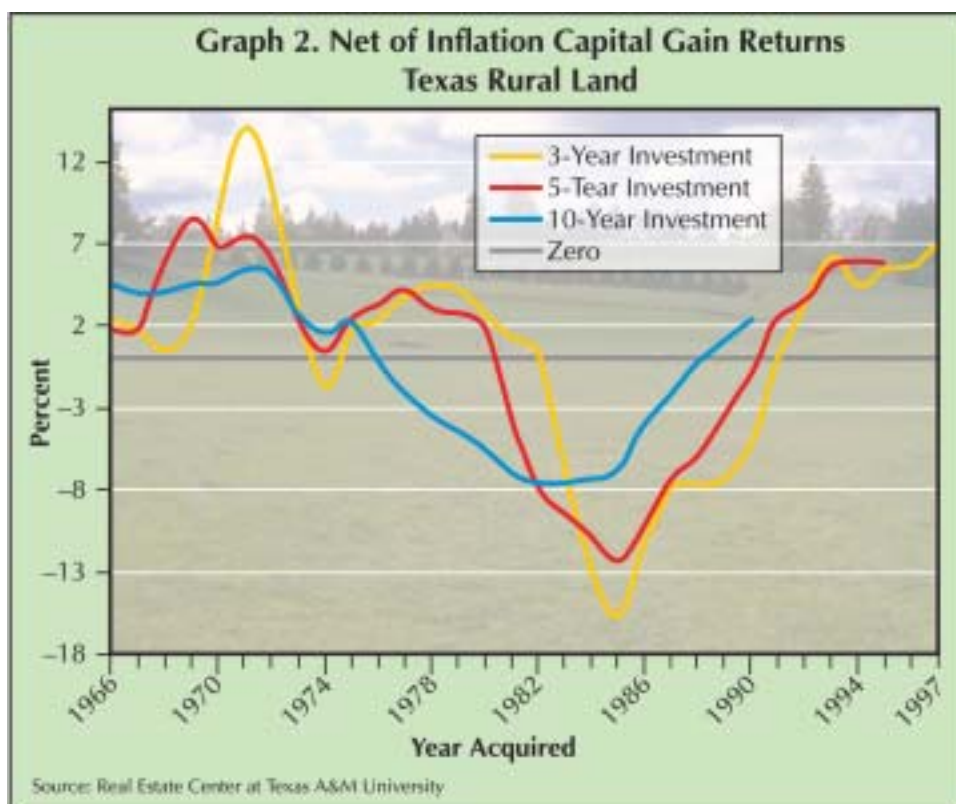
Small business owners also have contributed to demand in recent years, financing their purchases with 1990s profits. These business-owner purchasers continue to drive land markets in many locations, but they are much more careful in negotiating than buyers in the recent past. Available evidence does not indicate a rush to sell. In fact, purchasers still must

search to find good quality land. In addition, the terrorist attacks on the United States have created a climate of fear and uncertainty.

These factors paint a complex picture for short-term land price prospects. Removed from any urban influences, agricultural cropland likely faces several difficult years ahead. Experts predict farm profitability will languish for several more years.

Contrarians may see that as a signal to purchase cropland in anticipation of higher prices ahead for the middle-term or long-term investor. However, any short-term investment will likely fail to post the returns investors seek. The short-term prospects for rangeland, the kind favored by recreational buyers, are clouded by the uncertainty of the non-agricultural economy. However, short- and middle-term land investing has been profitable in recent years.

The prevalence of nonagricultural buyers illustrates the nature of current Texas rural land markets. As the state has become more urbanized, factors driving land markets have shifted to aesthetic appeal, recreational potential, development potential and water rights. The current market depends greatly on nonfarm economic





prosperity, and future markets likely will continue that trend.

The resolution of these stock market, high-tech industry and terrorist-assault-driven influences on land markets depends on the direction of the general economy. If prosperity returns in 2002, land markets should continue to prosper.

Population growth typically brings increasing incomes and a desire for land that leads to growing numbers of non-traditional landowners, altering the cultural makeup of the countryside. These trends have increasingly translated into efforts to control perceived threats to wildlife habitat and the environment. Such efforts inevitably impact landowners and land-use decisions.

### Fragmentation and Regulation

**B**ecause more people can afford to bid on smaller tracts, market pressures favor land ownership fragmentation. Owners, seeking to maximize their return, frequently split larger ranches into smaller properties to appeal to a broader market. New buyers often favor highly improved tracts. Therefore, although they buy unimproved land, they frequently erect large homes and surround their properties with deer-proof fences (see related article, p. 25).

Fragmentation of ownership creates a number of undesired effects. It often interferes with wildlife migration patterns, and it brings traffic and other urban problems to the countryside. Continued building and paving can strain water resources and increase rainfall runoff, causing flooding where it had not previously occurred. In addition, urban buyers frequently have no experience with the special challenges of country living, including managing wildlife, maintaining healthy septic systems and disposing of household trash. Some of these problems have prompted legal or legislative action.

In some areas over the Edwards Aquifer, regulations designed to protect aquifer recharge prohibit residential construction on sites smaller than five acres. The 1999 Texas Legislature gave counties the authority to require a developer to obtain a certificate stating that the property can generate sufficient supplies of groundwater when the development is completely built out.

These kinds of regulations address problems emerging as increasing numbers of people buy land in the countryside. The expanding rural population may lead county officials to seek ordinance-making authority. Additionally, Texans may press the legislature to enact statewide solutions to these problems. Regulatory measures tend to inhibit development and could affect investment return on land ownership.

### Conservation Influences

Conservation easements, which preserve habitat and the rural landscape, prohibit conversion of land from its current agricultural use to other uses. A landowner may grant an easement to a qualified entity, such as a land trust, and receive tax credits in exchange. The trust assumes a duty to ensure

## Continued building and paving can strain water resources and increase runoff, causing flooding.

that management decisions do not alter the character of the land. Building is frequently controlled or prohibited.

The long-term effect of an easement remains enigmatic. Prohibiting development means the property will never move to a more intensive use. This leads many to expect a decline in value. As time passes and fewer large properties survive development pressures, however, the development ban may enhance value as more people vie to own attractive landscape.

In the long run, population growth is expected to push up Texas land prices. Long-term investors may find it profitable to include land in their portfolios. However, they should anticipate increasing governmental over-

sight and conflicts arising from population pressures. Investors would do well to seek properties in locations where conflicts are well on their way to resolution or where there are limited chances of future confrontations.

Texas has embarked on an ambitious water planning program designed to secure adequate supplies through 2050. The first stages of the program have resulted in some sales of water and water rights. Not surprisingly, water rights have now acquired an economic importance of their own. Investors should carefully consider the water rights associated with land. As policy evolves, water rights could become more valuable than the land itself.

For the foreseeable future, the type of downside risk investors encountered in the 1980s appears to be unlikely. Short-



**URBAN DWELLERS**  
*continue to seek picturesque, peaceful rural properties for weekend getaways.*

term and middle-term investors are likely to see a slowing from the frenzied activity of the past few years with the potential for some weakening if the terrorist attacks inflict continuing uncertainty and economic erosion in the year ahead.

If the slowdown in the general economy turns the corner next year, markets should resume their upward march. Barring a prolonged recession, long-term land investments appear to be headed into the profitable range for some time to come. Some investors with long-term planning horizons may find that conditions are ripe for a return to the land market. ♣

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