

A Reprint from *Tierra Grande*

By Charles E. Gilliland, Michael Mays and Jonathan Sanders

Markets for Texas rural acreage remained robust, recording widespread gains in 2001. With a record high of \$945 per acre, the 2001 weighted median price was well above the previous high of \$865 registered in 1985.

Continuing drought, low commodity prices for many agricultural products and the September 2001 terrorist attacks led market observers to nervously anticipate weaker prices and slower sales. Confounding this widespread pessimism, the market registered a hefty 12 percent gain in 2001. Not since 1981 had such an increase been recorded.

The volume of sold properties reported to the Real Estate Center remained steady at 4,723 sales in 2001, ten more than in 2000. Statewide, the typical size of sold properties fell from 117 acres in 2000 to 101 acres in 2001 indicating a marked preference for smaller properties.

After adjusting for inflation, real prices settled at \$211 per acre, well short of the record \$288 per acre posted in 1984. Still the 2001 real price was 10 percent more than the 2000 median. That growth in real prices produced a 1966–2000 yield of 0.8 percent annual compound capital growth.

Higher prices were spurred by buyers with strong appetites for recreational land. Many respondents to the Center's fall 2001 survey of market observers listed hunting, fishing and other types of recreation as "very important" buyer motives (see Figure 1). Purchase for ranchettes or homesites also ranked as very important.

This widespread preference for nonagricultural uses has created a pronounced and widening gap between per-acre prices for small and large properties. In 1966, the typical small Texas

tract sold for \$206 per acre, approximately 64 percent higher than the comparable large property price of \$126 per acre. In 2001, the small tract brought \$1,302 per acre, 121 percent higher than the large tract price of \$589 per acre.

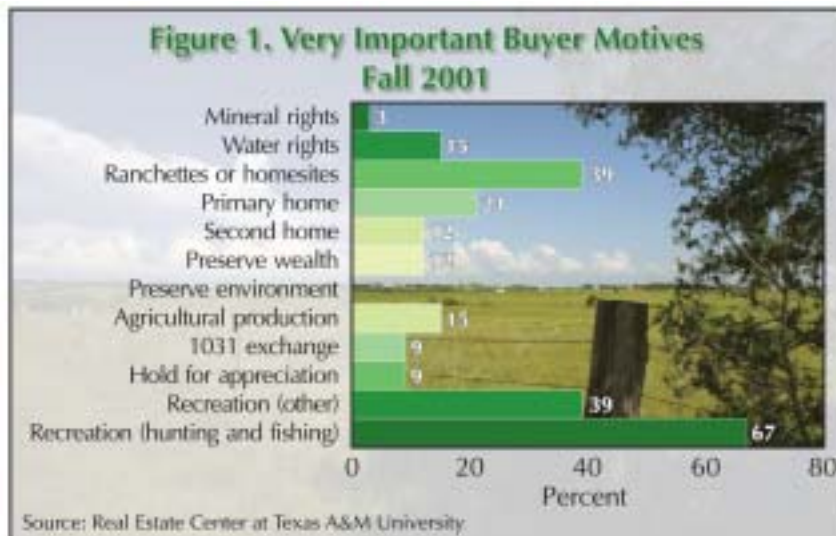
The compound growth in small tracts averaged 6.3 percent from 1966 through 2001 while the comparable large tract growth amounted to 5.3 percent annually. Interestingly, the size of a “small tract” (the smallest 25 percent of sales) varies dramatically statewide, ranging from 19 acres in the Lower Rio Grande Valley to more than 8,000 acres in the Trans Pecos.

Since the beginning of the current land market recovery in 1993, the disparity between per-acre prices for small properties and large tracts has widened rapidly. In 1993, small tracts sold for \$704 per acre compared with \$395 for large tracts, making small tract per-acre prices 78 percent higher than large tract prices, a modest increase over the 1966 differential of 64 percent. By 2001, that disparity had reached 121 percent. This price acceleration led to an eight-year small tract compound annual growth rate of 8 percent compared to 5.1 percent for large properties.

Strong demand for smaller tracts in 2001 suggests potential profit opportunities for dividing larger holdings. The large drop in statewide median tract size from 2000 to 2001 reflects the growing demand for smaller recreational and residential properties. More numerous sales of smaller properties at higher per-acre prices accounted for a portion of the strong 12 percent increase in weighted median price in 2001.

INVESTMENT RETURNS

Land and market investors frequently fit in one of three groups based on the preferred duration of their investments: short-term (three-year holding period), medium-term (five-year holding period) and long-term (ten-year holding period). The return on lands held results from income

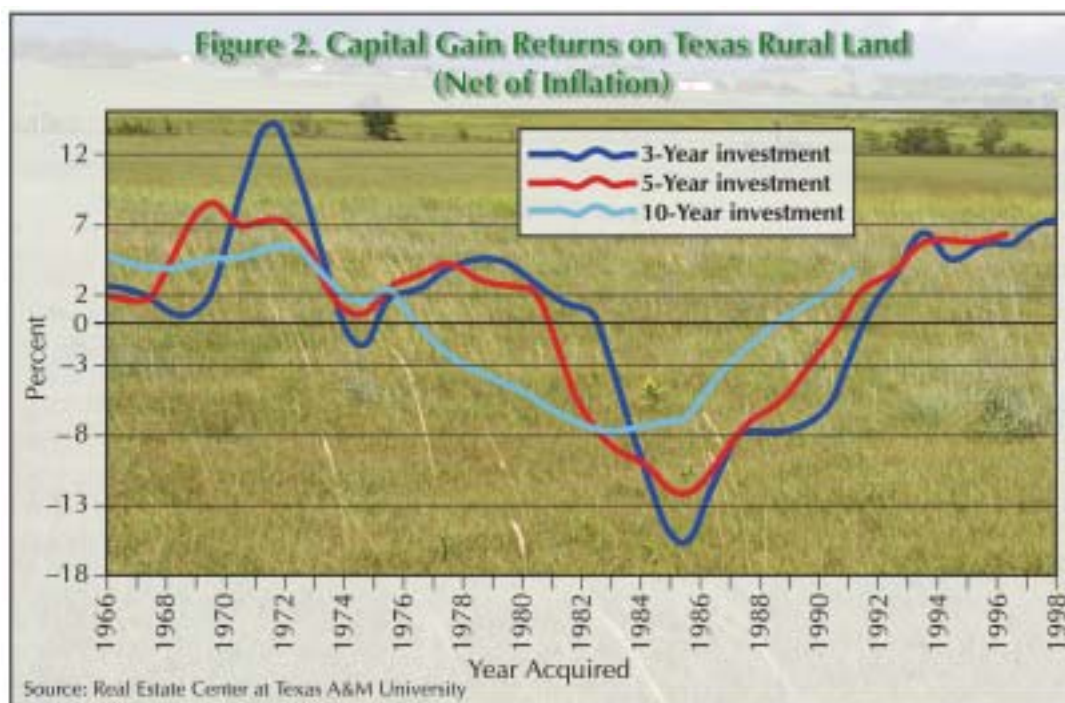


received during the holding period plus the increase (decrease) in land prices less the growth in inflation in the economy over that same period. Land price appreciation minus the rate of inflation equals the net capital gain return or return over inflation for holding the land. Figure 2 shows the net capital gain yields for various terms and investments in Texas rural land as measured by growth in the weighted median price per acre.

The gains reflect annual compound growth after deducting for inflation as measured by the implicit price deflator for gross domestic product. These yields do not include returns on agricultural or recreational activities or any sales costs. Positive returns indicate that appreciation exceeded inflation during the investment period. The year shown at the bottom of the chart represents the year the investor acquired the property. For example, 1966 corresponds to land purchased at the end of 1966 and sold three years later, in 1969, or five years later, in 1971 or ten years later, in 1976.

Between 1970 and 1983, real land prices rose. As Figure 2 reveals, short-term capital gains for land acquired during that period tended to range higher than medium- and long-term investments. From 1985 through 1993, growth in real price per acre first faltered and then declined. For land purchased during this time, medium- and long-term investment returns tended to exceed the short-term investment strategy.

As Texas land markets returned to positive real price growth after 1993, the advantage of long- and medium-term investments narrowed and eventually may vanish as the selling date for the medium- and long-term land holdings moves forward. Short-term land investments are favored in times of rising land prices while medium- to



long-term strategies are popular during difficult market eras.

In addition to timing, tract size influences land's marketability. Generally, the pool of potential buyers for a small acreage property is greater than for a large tract because more buyers can afford to invest the total required to buy the small tract. As a result, there is a greater potential demand for small properties, all other factors being equal.

Since 1993, three-year net annual returns for small Texas properties have averaged 5.7 percent. During the same time, three-year annual returns for typically sized properties averaged 4.9 percent while large properties returned 3.4 percent. This difference reflects the fact that smaller properties are generally easier to market.

Considering these influences on net returns, investors should consider both size and potential for growth in land prices as they search for a suitable investment. A buyer should probably consider purchasing several smaller properties rather than one large one. The buyer might consider purchasing a large property that could be divided into smaller units and resold, especially if the properties offer a potential recreational use.

OUTLOOK FOR TEXAS LAND MARKETS

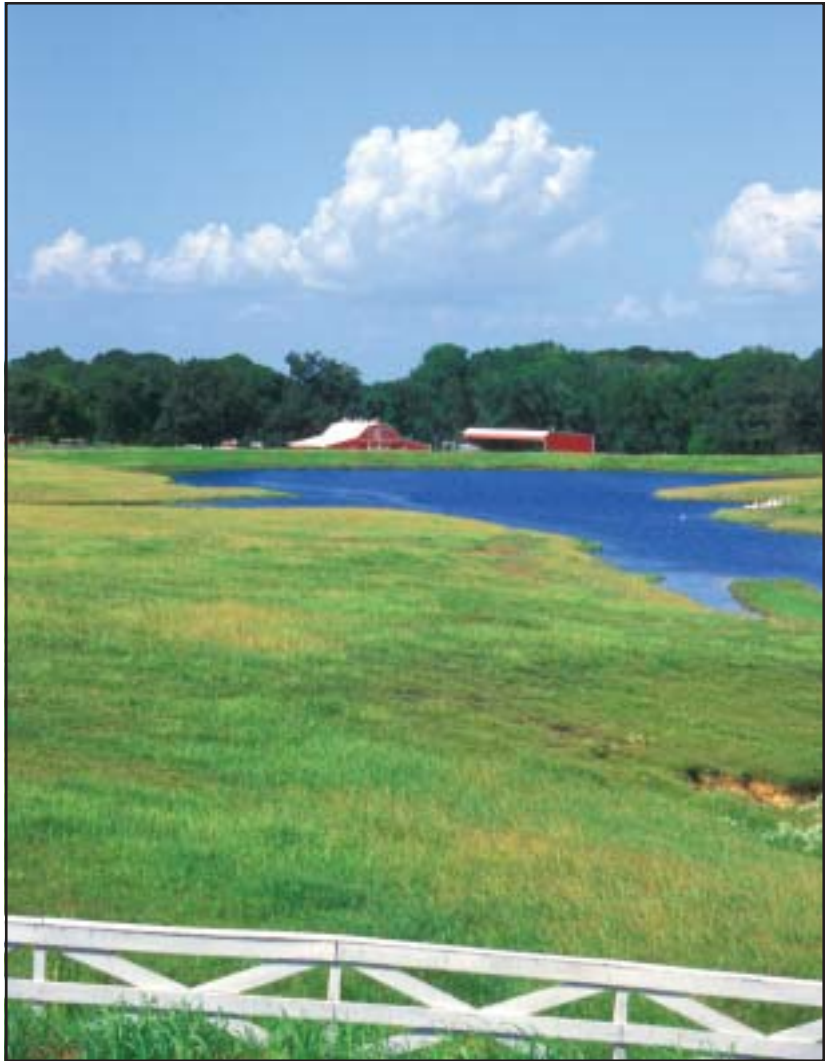
The prosperous decade beginning in 1993 propelled Texas land markets to an all-time high on a wave of demand for recreational properties. Many local land markets have fewer good properties, resulting in rising prices and a trend toward smaller acreage purchases. These characteristics point to a market buoyed by prosperity in the nonfarm economy that has endowed many with the means to buy property in the country.

The recurring litany of potential market threats center on poor conditions for agricultural producers. Drought and commodity prices continue to hamper farmers and ranchers. However, demand from urban-based consumers and government disaster payments have helped.

During the 1970s and into the 1980s, investors were significant buyers of rural land. However, the land market bust of the late 1980s sent investors scurrying into stock and bond markets.

Anemic interest rates and stratospheric stock prices coupled with growing concerns about the accuracy of corporate financial statements may be causing some investors to once again consider adding land to their portfolios. The Sept. 11, 2001, attacks and ongoing struggle with global terrorism have added to a feeling of uncertainty. That uneasiness has caused some investors to seek out land as a secure investment.

With land prices at record highs, many wonder if this recovery has run its course. While land prices have reached a record high level of \$945 per acre after adjusting for inflation, real land prices are only 73 percent of their record 1984 high. In fact, real prices have recovered only the losses suffered in the 1986-87 collapse. Prior to 1986, land prices last approached current inflation-adjusted levels in 1973. With current prices comparable to 1973 levels, the demand for rural properties should increase.



TEXAS RURAL LAND is more often bought for fun than farming as city folks search for out-of-the-way places to relax and rejuvenate themselves.

With the exception of areas hit hard by the woes of the high-tech industry, it seems logical to look for higher land prices across most of Texas. Farmland prices may stabilize instead of increase, but in the remainder of the state, prosperity should return with the economic rebound anticipated later in 2002.

The overall lack of good properties for sale means that future demand faces a market constrained by a restricted supply. Growing demand and dwindling supplies point to higher prices in the next year to 18 months. However, the rate of price growth may moderate from the high levels posted in 2001, and some regional markets registering sizable gains in 2001 may post moderate price growth as buyers locate acceptable substitute properties.

Long-term prospects also appear to be positive. Projected population growth in the next quarter century suggests increasing competition for land ahead. The growing demand for space chasing an ever restricted supply spells prosperity for landowners. However, timing the arrival of those thriving long-term price increases remains difficult. Therefore, potential investors should be prepared to hold land investments well into the future. ♣

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