

A Reprint from *Tierra Grande*

Over the past few decades changing business economics, expanding population and prosperity have fundamentally changed the East Texas land market and the timber industry that once drove it. A market previously dominated by timber producers has expanded to include buyers interested in hunting, hiking, fishing, camping, conservation uses, second homes, retirement property, small farms and investment properties. Maximizing returns on timberland these days calls for a flexible marketing strategy — that is, evaluating each tract's potential nontimber uses and targeting the market that would bring the highest return.

The Big Sell-Off

Understanding how this market change evolved requires insight into how large timber companies view land ownership. The conventional view taken by these companies has been that land is one homogeneous asset like other forms of capital. And like other assets, land must provide a return exceeding a corporation's required minimum return rate for investments.

In the past, timber companies acquired vast tracts of East Texas timberland and managed them to supply their wood and paper mills. However, rising operating costs including taxes, labor and energy combined with flat timber prices have prompted many owners of large timberland tracts to sell their holdings. In recent decades, timber companies have sold approximately 1.8 million acres, an area more than half the size of Connecticut.

The sell-off began slowly and attracted little notice in the booming real estate markets of the late 1970s and early 1980s. Continued sales during the mid-1980s real estate crash also went largely unnoticed. During that era,

many owners of "smaller" properties (tracts from 10,000 to 100,000 acres) sold much or all of their land. Timberland investors liquidated their holdings for various reasons. Purchasers subsequently subdivided many of these properties for resale. Entities selling during that time included the Baptist Foundation of Texas, Foster Estate, Mitchell Southwest, Exxon-Friendswood, Lowery Brothers, the Carters and Champion Realty Corp. All told, 219,000 acres were sold.

As timber prices declined in the 1990s, companies including International Paper, Gibbs Bros., Champion International Corp. and Louisiana-Pacific sold or announced the sale of an additional 1.6 million acres. (See "Timberrrrr! Soft Woods Fall on Hard Times," *Tierra Grande*, July 2003, for details.) Most of this acreage is in East Texas, in an area bounded by The Woodlands and Beaumont on the south, I-45 on the West, Longview-Tyler to the north, and the Texas-Louisiana border to the east. In the past three years, the sell-off pace has quickened.

New Marketing Strategy

Today's recreation-driven rural land markets are compelling timber companies to reconsider established asset management practices. Instead of treating timberlands as homogeneous assets, timber companies must manage multiple land tracts like any complex group of real assets, analyzing each tract's characteristics and market potential.

The parcel's shape, size, frontage, access, location, topography, drainage and utilities must be taken into account along with features such as wetlands preserves and flood plains. Conservation and environmental factors, timber volume and potential and recreational, residential and commercial devel-

opment possibilities should be factored into the marketing analysis.

Each tract analysis should include a ranking by potential dollar value in envisioned uses to identify the most likely market for each parcel. Factors driving each market, including competing properties and developments, should also be evaluated.

Once the most marketable use is established, a management and marketing strategy should be developed to bring the best price on the sale of each parcel. At the same time, the seller should develop a strategy to minimize ad valorem taxes. Timber harvest plans for each tract should be scheduled to coincide with the land's projected future market or markets. These schedules should reflect the relative values of transitional uses, timing harvests to contribute to any future, higher valued use. Typically this would mean more selective, marked cuts and less clear cutting.

Who's Buying?

While timber tracts of 20,000 acres or more have not appreciated in recent years, 20- to 100-acre parcels have risen sharply in value. The rapidly swelling ranks of recreational buyers are behind the change. Further, a recent study of Generation X investors (those 22 to 36 years old) found that they are buying more real estate and reducing investments in mutual funds and stocks. The same trend is occurring among older investors, indicating a growing appetite for land ownership.

Much East Texas timberland is located in regions the Census Bureau refers to as nonmetro adjacent counties. These rural, second-tier counties next to more populated metropolitan statistical areas (MSAs) may experience explosive growth as Texas' largest cities (Houston, Dallas and San Antonio) expand. Land prices in these counties are a good barometer of current economic realities. In some instances, buyers can purchase 15- to 60-acre tracts for the same price as a single developed residential lot in the Houston MSA (\$45,000 to \$150,000.)

Performance of alternative investments has languished in recent years, making rural land investments even more desirable.

In many areas of Texas, land values have appreciated faster than the rate of inflation. And unlike stocks or bonds, land can be used for hunting, camping, hiking, wildlife and water conservation, timber and livestock production and numerous other activities. Financing for undeveloped land is readily available, thanks to an abundance of well-funded investors seeking reliable returns.

According to the U.S. Department of Agriculture, forestlands have generated the majority of international investment in American agricultural land, accounting for nearly half of all holdings in 1995. The falling dollar will enable non-U.S. buyers to purchase larger acreages and may, therefore, attract more international investors to timberland investments. For the next several years, non-U.S. investors may be the best hope for timberland owners who want to sell large tracts.

The specter of inflation appears to have influenced some land buyers. Mindful of continuing interest rate cuts and the pool of funds seeking viable projects, these buyers have turned to land investments for security. Eroding capitalization rates have caused observers to fret about the prospect of deflation. However, some investors are anticipating that the Federal Reserve will tolerate more inflation in the future as part of a strategy to avoid deflation.

Uncertainty in international affairs has prompted other buyers to see land as a safe haven for a portion of their wealth. Although evidence of this remains anecdotal, market observers have noted an increasing number of buyers seeking to park capital in tangible assets like land. Large timberland tracts may be a good option for buyers with sizeable sums to invest.

Ultimately, the new realities of today's markets will change the face of East Texas timber country. As large tracts of timberland are subdivided and sold, the landscape of the region will change. This transfer may be the harbinger of changes in the social and economic climate of East Texas. ♦

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Tierra Grande (ISSN 1070-0234), formerly *Real Estate Center Journal*, is published quarterly by the Real Estate Center at Texas A&M University, College Station, Texas 77843-2115. Subscriptions are free to Texas real estate licensees. Other subscribers, \$20 per year.

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