

A Reprint from *Tierra Grande*

\$ the Price is Right

By Charles E. Gilliland, Gerald Klassen and Nirad Pachchigar

Land and market observers and participants alike are apprehensive about the frenzied atmosphere in the market. Noting an increase in borrowing among buyers and skyrocketing price increases, many fear that current market conditions will be unsustainable in the long run.

These misgivings have emerged as Texas land markets continued to push into uncharted territory in 2006. Driven by an unprecedented demand for land, the statewide price per acre jumped 23 percent over 2005 market levels. The price of Texas rural land soared from \$1,483 per acre in 2005 to \$1,825 per acre in 2006 (Figure 1).

The 2006 price represented appreciation at a 14 percent annual compound rate since 2001 and a more than 93 percent total increase over the five-year period. This was the fourth straight year annual price growth exceeded 10 percent.

The real or inflation-adjusted price of \$365 per acre in 1966 dollars pushed past the previous record high set in 2005 by \$59 per acre. Nominal prices shown in Figure 1 reflect the actual prices paid while real prices represent nominal prices adjusted for inflation. The real price change, in terms of purchasing power, shows prices rose 20 percent above inflation in 2006.

Sales volume remained strong (Figure 2). Fueled by high demand, Texas recorded 8,215 sales, slightly below 2005's record volume of 8,368. The explosion in land-buying activity that began in 2002 continues unabated.

Property Size

At 98 acres, the typical transaction remained at the low end of the size spectrum. Tract size has fallen below 100 acres and remains substantially less than the 140-acre levels posted in 1997-98 (Figure 3).

The drop in tract size roughly coincided with the increase in sales volume as a growing number of buyers scoured the countryside for properties that met their land purchase budgets. The rush to subdivide larger holdings has resulted in a shortage of larger properties.

Buyers clamoring for larger holdings no longer choose among properties sellers have placed on the market. Instead, a buyer's representative now frequently locates a property matching a seller's specified search criteria and approaches the owner, making repeated offers until he or she decides to sell. The prevalence of these bidding transactions may be partially responsible for the sizable increases in market prices.

Specifically, these buyer-initiated transactions normally focus on highly desirable properties. Therefore, they could alter the market's composition by including a higher percentage of superior-quality properties than in the normal historical setting in which buyers choose from listed properties. If current sales consist heavily of the highest quality land, the measured appreciation rate may be higher than the actual appreciation rate for the state as a whole.

Figure 1. Texas Rural Land Prices in Dollars Per Acre

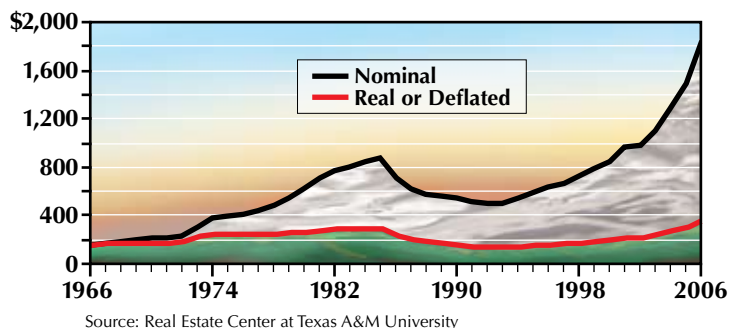


Figure 2. Texas Land Market Volume

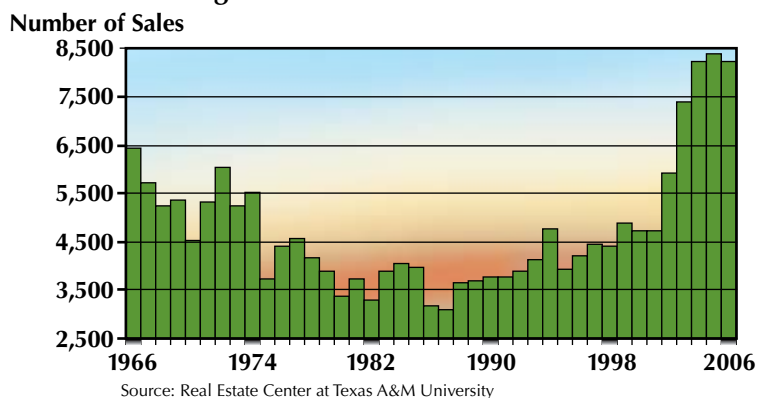
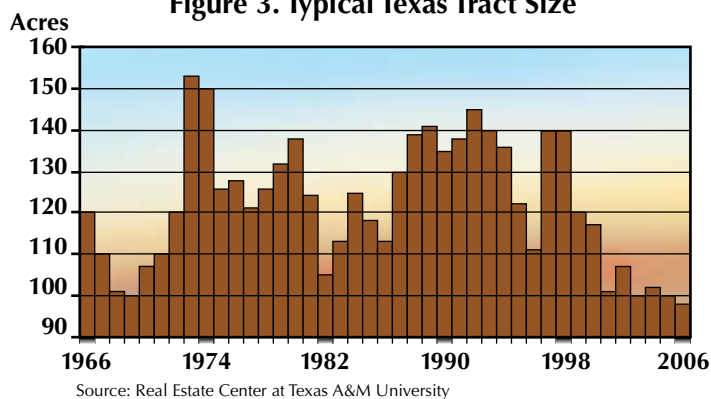
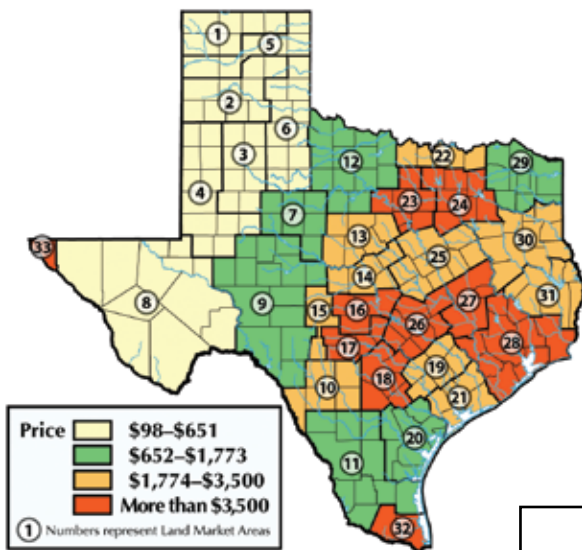


Figure 3. Typical Texas Tract Size



**Figure 4. Texas Rural Land Prices
2006**



Source: Real Estate Center at Texas A&M University

As Texas evolved from an agricultural to an urban-based society, nonfarm buyers flocked to the countryside, buying acreage for recreation and investment. In the past decade, these buyers have come to dominate market activity.

Many land market participants note that 1031 exchanges, often involving buyers from outside Texas, are motivating a substantial number of transactions in Texas land markets. And rising corn prices, in response to an expected increase in demand for ethanol, have prompted farmers to return to the land market. All three of the traditional pools of prospective buyers — consumers, investors and producers — should be active in Texas' land market in the next year.

Regional Developments

In 2006, the geographic distribution of land prices (Figure 4) continued to reflect both population density and the draw of scenic properties. Most of the higher prices occurred in the heavily populated eastern portion of the state.

The highest prices surrounded Dallas–Fort Worth, Houston, El Paso, Austin and the Lower Rio Grande Valley. The Hill Country's high prices stretched westward from Austin through Fredericksburg to Kerrville. The lowest-priced land ran through West Texas from Amarillo to the Trans-Pecos area to the Rio Grande.

The highest percentage price gains were geographically dispersed (Figure 5). Urban areas near Houston, Dallas and San Antonio all increased more than 30 percent, fueled by demand from homebuilders, developers and private equity firms. The Wichita Falls area continued to grow rapidly, as did San Antonio and Fredericksburg. The largest percentage price jump was in the Trans-Pecos region, where small properties sold in larger-than-normal numbers, substantially driving up the median price for the area. None of the regions posted lower prices.

What Next?

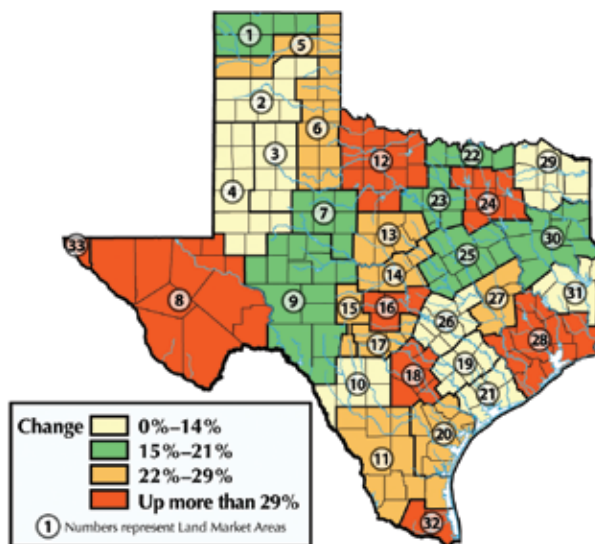
Market developments in 2006 reflected an increasingly intense contest for control of the Texas countryside. Investment-minded buyers continued to pour funds into land purchases, and recreational buyers rushed to get in before prices climbed even higher.

In 2007, forces propelling prices upward have accelerated and expanded. Markets appear poised to reach even higher levels. Some investors seem to sense inflation ahead and are searching out tangible assets, including land. Tax considerations continue to spark demand for land as well. Meanwhile, institutional and foreign investors have developed an appetite for Texas

forest land. These circumstances have prompted market participants to repeatedly note a dearth of quality listings. Brokers are maintaining long lists of potential buyers.

A number of potential pitfalls are on the horizon. High energy prices could adversely impact the demand for recreational

**Figure 5. Change in Rural Land Prices
2005 to 2006**



Source: Real Estate Center at Texas A&M University

and development land. Further interest rate hikes may take a toll. Farm policy is in complete disarray, so no one can realistically predict operating conditions for farmers in the near future.

Despite these potential problems, current activity suggests that by the end of 2007, Texas land prices will post another sizable gain. ➤

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THE TAKEAWAY

Texas rural land prices increased 23 percent in 2006. The current statewide price is \$1,825 per acre. Volume of sales remained strong with 8,202 sales in 2006. Markets in 2007 remain robust.



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