High-priced land can still be sensible a investment
By Curtis Seltzer
Creative Real Estate Magazine, May, 2008

America's historical engine of settlement was the desire for land. Rich people wanted it, as did everyone else.

The stories of how we as a people acquired land from Native Americans, from each other and from public authority is as uncomfortable to read as any slave narrative.

Land, of course, meant that the landless had a way of making a living, and, if not that, at least surviving until better times appeared. Land also meant the prospect of wealth, which each of our Founders understood. Eighteenth century Native Americans called the surveyor's compass a "land thief," with good reason.

Today, most Americans do not need land to meet their survival needs. Wealth, too, is no longer land dependent.

A billionaire might occupy no more than 3,000 square feet above Manhattan—3,000 very expensive, very exclusive, very embellished square feet. And all of his wealth would appear in a monthly statement as shares of this or that.

But I think this decoupling of wealth from land is changing; I think we have started to go back to the future.

About nine percent of all U.S. homeowners own a second home. And that base is projected to gain about 160,000 units annually during the near-term future. As population continues to increase, the market for land and second homes will strengthen.

Both the New York Times and the Wall Street Journal have run features in recent months on the migration of wealthy folks back to the countryside. They're looking to preserve it, not exploit it. But when they sell, they make money.

Want real proof? Cheap land no longer exists.

The transformation of land from something that had value because of what it could produce as food or product to something that has value largely for its aesthetics and the recreational amenities it affords has profound long-term implications.

The people who buy land today are different. They are not, as a rule, farmers who make their living from farming. They are not, as a rule, trying to build wealth through the accumulation of land.

In a sense, they are voluntary refugees who make their money in the cities but choose to spend discretionary time in country places.

It's taken a while, but they've unwittingly brought with them the inflated values of their economic base.

And that explains why a couple of so-so acres in a so-so West Virginia county about four hours west of Washington, D.C. now sell for $10,000 per acre rather than the $2,000 of ten years ago or the $500 of 20 years ago or the $100 of 30 years ago.

Amenity-driven inflation has priced farmers out of buying farmland for farming and timber owner of buying timberland for timber production.

* * *

So how can buying inflated value still be a sensible investment?

First, because demand for land by individuals who are able and willing to keep paying higher prices is growing. As our economy and society increasingly benefits the upper third of us, these buyers will grow as a group and continue to bid up the price of increasingly scarce second-home land within a reasonable driving distance of urban areas.

It's arguable that the price inflation in country property -- second homes, recreation tracts, farmland, timberland, conservation parcels -- is just another bubble about to pop. I don't agree, generally speaking, although credit tightness and economic malaise may slow demand for specific second-home projects in built-up areas like Florida.

What I think is happening in the slowed land sectors is a common-sense price correction, which will do its share to bring land buyers around once the rest of the system sorts itself out. I see no diminished demand for land; I do see fear of buying in uncertain circumstances.

Look at the investment opportunities in three sectors—farmland, timberland and conservation properties.

The factors that have been driving higher prices for good farmland around the country for the last 20 years are fundamental. But it would be silly for an investor to pay inflated value for cropland based on the recent ethanol-driven run up in corn prices and the frenzy in wheat. These are short-term price bubbles that can't sustain themselves.

I would avoid buying marginal cropland—the dirt that in normal times would probably be grazed or left idle. When crop prices correct themselves, prices for this type of land will fall fastest and hardest. Perhaps the best investment values are now found in average cropland that is reasonably priced. It will not be as productive as prime dirt, but it will be good enough to produce crops profitably.

Certified organic farmland carries a price premium because of the labor, cost and care needed to achieve certification and maintain that status. The wealthier one-third of our population will continue to provide an expanding market for organic foods. Organic production is generally riskier, but the organic industry is becoming ever more knowledgeable.

Investors should look for certified organic land or, better still, land that can earn certification without huge additional effort; the latter will be cheaper.

Buying farmland at prices justified by long-term farming prospects makes investment sense. Bubble prices should be left to Lawrence Welk fans and exotic dancers. Buying farmland at prices that reflect highest-and-best-use value makes sense only if you're a developer.

Timberland prices are being driven by investors (individuals, pension funds, developers, endowments, etc.) who are looking for annual cash flow from timber harvesting and long-term profit from appreciation. Because timberland can be divided and sold to recreational-land buyers and second homers thus guaranteeing a profit, its price has increased steadily during the last decade, pretty much independent of the ups and downs in stumpage prices for various species. (Stumpage price is what a timber buyer will pay a landowner for his merchantable timber, that is, timber with value to the buyer.)

It's the higher-and-better-use values of timberland to urban buyers that will continue to boost its value. That's a fundamental, not a bubble. If you can buy timberland at timberland prices, you'll make money.

Timberland can also help an investor through: 1) a 1031 exchange; 2) the donation of a conservation easement that brings significant local, state, federal and estate tax benefits; and 3) state property-tax relief when the land is enrolled in a state's managed-timberland program. On the possible horizon is payment to timberland owners for the carbon dioxide that their woods remove from the atmosphere.

Conservation property is a genuine growth market with two engines: Greenie Boomers who want to preserve land in its current use, and hunters who want to preserve wildlife and game habitat. Both types of buyers are looking for the aesthetic benefits of stewardship and the significant tax benefits that follow their donation of a conservation easement.

About ten million privately owned acres are now under conservation easements, and buyers are paying ever higher prices for land that would qualify. Timberland and ranches in areas where green buyers like to wad up – New England, northern California, the Rockies and parts of the Southeast – are where investors should focus. Not all land has conservation value.

Conservation property that provides habitat can be the most rugged, most extreme, most remote, least productive and all-around junkiest. An investor who buys junk land at a junk price may be able to make a profit by reselling it for a higher and better use—as conservation property where everything is kept as it is. (Since federal law limits or prohibits development on habitat for endangered species, the investor needs to research the likely conservation easement value before making an offer.)

As I write this at the end of February, the legislation that would renew the current level of generous tax breaks for conservation easements is in conference. In 2006 and 2007, a taxpayer could deduct the full value of the donation up to 50 percent of his adjusted gross income in a year. Unused value could be deducted over 15 years.
If the current breaks are not continued, it's likely that the less-generous pre-2006 incentives would be reinstated.

Investors should be very wary of buying land where a conservation easement has severed one or more valuable property rights. I offer four reasons for that opinion. First, the seller has taken the tax benefits from the donation, which denies them to the next owner. Second, the language of the easement may be ambiguous, too restrictive or just plain goofy in the circumstances. Regardless, once in place, the easement remains as is forever. Third, land sellers with conservation easements tend not to discount their price sufficiently to reflect the absence of development rights. Finally, the new owner has a property that will appreciate significantly less in the future owing to the restrictions.

* * *

I offer four other reasons why investors should still consider country property even when values appear inflated compared with the past.

Country property prices rise in proximity to an urban area and/or to a destination amenity, such as a ski resort, lake, beach or scenic spot. Think of value inflation as a wave that's highest nearest the urban center or the core amenity but extends – with declining strength – outward, usually, in all directions. As prices rise near the cores, they boost outlying prices as well.

The place to look for good investment value in land is not in the first couple of rings closest in to the core areas, but in the two or three outer rings. There, you're likely to find cheaper prices and higher rates of appreciation with less risk

The first reason, then, is simple: the more we increase our urban/suburban populations, the more valuable land within a reasonable driving distance will become.

Second, most country property is a safe investment over time as long as the top third of us continue to get richer. Since land is finite, an aptly situated parcel with one or more coveted amenities – view, woods, stream, pond, privacy – will always be in demand.

Third, the per-acre price of land is discounted as the size of the parcel increases.
Five thousand acres might be purchased for $1,000 per acre whereas 200 acres of that entirety might fetch $3,000 per acre, or more. Accordingly, investors can offset some of the embedded price appreciation by buying larger acreages that carry the price discount.
If larger acreages are not discounted, they're not likely to make good investments. This situation lends itself to investors going in together to buy larger tracts at cheaper per-acre prices.

Finally, land provides multiple opportunities for profit. Crops and livestock can be produced. Timber can be sold. Hunting rights can be leased. Buildings can be rented. Minerals can be leased and royalties collected. Land can be divided and sold – in whole or part -- for a higher dollar price per acre than as an entirety. Many tax benefits can be taken. And, finally, land appreciates in value. It's also transparent and understandable unlike stocks.

Land is the safest, least risky, most likely to succeed long-term investment available to ordinary Americans. It has risks, and each property needs to be thoroughly researched to determine its value and potential.

But when all is said and done, land – even at inflated values – is cheaper today than it will be in the future. Anyone of us who bought 100 acres anywhere 30 years ago would make money on its sale today—a lot of money.