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Financial factors impact real estate positively and negatively
By Curtis Seltzer

Spring is coiling, but not yet sprung. Spring brings buyers into the countryside. That's how it usually works, anyway.

Land buyers and sellers need to give some thought to the odd financial environment that exists. Here are a few items to consider:

Interest rates. Advertised rates for a 30-year, fixed-rate mortgage are very low right now, in the 4s and 5s. Getting a 30-year, fixed-rate mortgage in the 4s and 5s right now is very hard.

Loans being made for farms and unimproved land are in the 6s and 7s, depending on the amount of cash the buyer fronts and the term.

The lack of feasible credit and the interest rates that are actually available are hindering sales in rural real estate. The market tends to be limited to cash buyers.

Refinancing property at the advertised rates is largely wishful thinking.

The Washington Post carried a story in mid-February ("Refinancing unavailable for many borrowers" by Dina ElBoghdady and Renae Merle) that reported "…millions of homeowners…[can] not qualify for the best rates." The decline in property values has made refinancing difficult, along with tightened standards and a general lender disinterest in any but the safest and most readily resold mortgages. On March 3, 2010, Nick Timiraos reported in the Wall Street Journal that while the Federal Reserve has pushed mortgage rates to 50-year lows, "millions of U.S. homeowners haven't benefited from that because they can't -- or won't -- refinance."

I don't see interest rates and credit availability improving in the near future. The Fed is committed to raising interest rates to control inflation. Two years from now, buyers of farms and land may be working with interest rates in the 8s and 9s. This will put pressure on sellers to lower prices and help with the financing.

Getting into a fixed-rate, long-term mortgage for rural property today is likely to be better than waiting…if you can.

Taxes. If you are "rich," in the way President Obama defines the word, you will be paying higher taxes in the future. His proposal is to let the Bush-era tax cuts expire for this group.

For couples earning more than $250,000 a year, the proposals involve raising the top income rates of 33 and 35 percent to 36 and 39.6 percent; adopting an additional 0.9 percent Medicare payroll tax; imposing a 2.9 percent Medicare tax on investment income; phasing out personal exemptions; and reducing itemized deductions.

For wealthy land investors, the heavy hit will be the rise in the capital gains rate. Under the Administration's proposals, the 2011 top rate on capital gains would be 20 percent rather than the current 15 percent.

Another idea is to limit itemized deductions to 28 percent for wealthy couples. Such taxpayers could no longer deduct against their higher-than-28-percent rates, but only against 28 percent. This increases their tax burden. This proposal would also cover deductions for mortgage interest.

Mortgage interest deductibility has been on many tax-reform hit lists. It doesn't seem to be in the Obama works. Tax breaks for conservation easements, second homes and rental income do not seem to be in the cross hairs. Obama's proposals assume keeping a federal estate tax at a $3.5 million exemption per person and a top rate of 45 percent on taxable estates. I've not heard that the 1031-exchange rule is in jeopardy.

If you are not in the top income brackets, many of the proposed tax increases should miss you.

Accordingly, a land buyer who is below the top capital-gains rate should be in the same position in the coming years as he is today. But who really knows?

It's difficult to say how "tax reform" will net out for a particular individual, since the specifics are still up in the air and circumstances change for each individual over time. The best we can do in this situation is to push every investment decision through a current tax-impact filter. Clearly, wealthier investors will be paying more taxes, but those not in those brackets may not see much change in their burdens.

Property taxes. You have to assume that local property taxes will rise as state budgets reduce expenditures.

The relationship between selling prices and property-tax burden is not always straight forward. Where taxes are high in Michigan, prices for timberland are still far too high in my opinion. In New York, another high-tax state, selling prices are high compared with the past, but low compared with other states—this is the pattern that you might expect. In certain low-tax southern states, prices are still high historically—another pattern that might be expected.

Buyers should run projected property tax hunches through their investment analysis. Fortunately, land-use and timber-stewardship tax breaks can take some of the sting out of property taxes on land and farms.

Employment and the overall economy. I'm with the group that believes we will stagger along with high unemployment, high underemployment, discouraged workers (who no longer seek employment) and a long-term thinning of the economic middle class. If this is true, some number of land and second-home buyers will not come back or come back weaker (looking for 25 acres rather than 100).

But the high end is still likely to be in the game. Robert Frank in the February 13-14, 2010 Wall Street Journal reported that unemployment among individuals earning more than $150,000 a year was only three percent in 4Q 2009, compared with an overall rate of about 10 percent. I'm not saying that the recession has spared the upper-middle and wealthier classes. I'm only saying that it has disproportionately landed on those in the middle and below. Wealthier individuals and institutional investors will still be in the farm and land markets, but they may scale themselves back a bit and be unwilling to pay the prices that were tacked up in 2007-2008.

Demand for most agricultural products is likely to be strong enough going forward. Demand for stumpage and wood products will take a longer time to come back and regain the prices of five or six years ago.

All of these financial factors -- interest rates, fixed-rate mortgages, capital gains rates, property taxes and macro-economic trends -- need to be considered before buying rural real estate. They are part of a buyer's due diligence.

Taken together, they appear to net out as a more financially onerous environment than we have today. That, I think, puts pressure on sellers to lower their prices, both now and in the future.

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