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Will economic weeds produce the wave of the future?
By Curtis Seltzer

BLUE GRASS, VA.—I don’t have a very good nose, but even mine has been curling up at the bad-fish smell rising from the rural real-estate market.

Financing for many types of properties -- some farms, second homes, undeveloped land, timberland and recreational property, among others -- is either hard to get or only available on out-of-whack terms. Credit is not fully stoppered, but it sure is clogged.

I asked two dozen readers of Country Real Estate to give me their impressions of how such properties were moving in their areas compared with two years ago. The group included real-estate brokers, financial advisers, consulting foresters, investment managers, lenders and individual investors.

This is not a rigorous, scientifically valid opinion survey. I am not a rigorous, scientifically valid kind of guy.

**Future-spook.** Most buyers, it appears, are scared of the big stuff—the five-to-10- year prospects for the economy, consequences of federal bailouts and borrowing on inflation and taxes, increasing cost of middle-class life and a feeling that a lot of what used to be fairly predictable is now fairly chancy.

“From my perspective,” wrote Tom Brickman, head of Southern Rural Land Sales in Alabama, “the main factor affecting the rural land business is uncertainty from many points of view—interest rates, taxes, employment, expanding role of federal government. Buyers AND sellers are both ‘sitting on their hands waiting for someone to blink.’”

Two types of land buyers have disappeared. Both buy-and-flip purchasers and developers (who buy large at wholesale, and sell divided at retail) are now sitting high in the stands, far behind the sidelines. Investments are no longer being made on assumed rates of steady appreciation. Speculative buying is a memory.

**Sales have fallen; some prices have, some have not.** Visit the website of almost any broker who works with country property and you will find a large inventory in most property categories. Some listings have been hanging around for two years, or more, for lack of price reduction or lack of able buyers.

Most readers report that land tracts are not moving, or moving slowly. One broker said: “People with money are waiting; people with land don’t want to sell at this time. It’s as if everyone is waiting to see what will happen next.” Another broker reported that his 2008 sales were half 2007’s, and the average per-acre price for land and farms had dropped more than $550 to $2,220.

Sellers who can wait for their price…have been—almost everywhere. Perhaps that reflects confidence in a future rebound. Or maybe it represents a calculation that taking a bath now is more painful than hoping for something “to turn up,” like Mr. Micawber in David Copperfield.

These “waiters” rely on other assets and income to muddle them through the economic pinch that’s touched everyone, everywhere.

My general impression is that most sellers are trying to stick to 2007-type prices if their circumstances permit. Distressed sellers are coming off a 2007-type price by 10 to 30 percent as a group, but in individual cases by 50 percent.

And yet, I ran into sellers in New York and West Virginia last month who believe that their undeveloped properties have appreciated 30 to 60 percent since 2005. When asked on what basis, say, a $100,000 tract back then is now priced at $150,000, the best answer I got was, “just because.” I was not persuaded.

Ed Hicks, a North Carolina broker and forester with United Country—Timberland Investment Properties who handles recreational and timber tracts from Tennessee to Florida, says that he’s seen “true timberland investment tracts drop to $800-$1,500/acre from highs in the $3,000-$6,000 range in south Georgia, north Florida and rural South Carolina.” These highs were speculative prices with no support from actual timber values, he added. “Prices of recreational tracts have fallen, but, more importantly, sales have fallen. Banks aren’t excited about lending for land purchases.”

But Stephan Tomlinson of Alabama’s Natural Resources Group found that prices for recreational properties have stayed relatively steady, though buyers want smaller tracts. “Same buyers, smaller budget,” he wrote. He’s also starting to see land liquidations by Real Estate Investment Trusts (REITs) and Timber Investment Management Organizations (TIMOs).

Some sources reported that sales of large timberland tracts are off in number and price, but J. Brian Fiacco at Timberland Strategies, LLC, who tracks large institutional and industrial sales says that such transactions “…still have not seen the major declines that have been so widely reported.” His guess: “perhaps a 10 percent [sales] decline from the very peak.”

Sales and prices of productive cropland seem to be holding their own in the

Midwest, despite a drop in agricultural income. Such land should pay for itself over time and has been seen as a hedge against inflation.

The sales-and-price story is grimmest with rural second-home developments and vacation-home projects in traditional destinations like Orlando. Those situations favor buyers.

Price is now the make-or-break factor with most properties in most areas with cash buyers. With credit buyers, it's both price and financing.

**Money is and is not around.** The big national and regional banks are not willing lenders for many types of country properties. If they can sell the note, they might make the loan, but they are not making it easy for borrowers interested in something other than a single-family, primary residence.

Bob Turner, a Memphis-area broker at Southern Properties, said that "the main problem with subdivision development lots.., farms and commercial developments…is financing. The world of financing took the United States from a credit-based economy to a cash-based economy in a matter of months, and it will take years for everyone to build up the cash to be able to put the money down required by the banks."

Stephen Dorris, an investor and forester in West Tennessee, agreed: "Money is hard to come by as banks do not want to lend unless the buyer can prove he or she really does not need the loan and that he can show repayment on paper. Cash flow is king now." A real-estate lawyer in upstate New York and brokers in Michigan, Virginia and Illinois agree: the problem is financing.

Observers have different takes on the Farm Credit System, a national network of cooperatives that makes a large portion of all loans in rural areas. FCS rates tend to be higher than others.

Farm Credit offered someone I know well (794 credit score) a 7.675 percent fixed/30y refinance rate last week on a three-property package (house/farm, timberland and business office). This translates to 6.908 percent, assuming a 10-percent dividend on the required stock purchase. The borrower's collateral was valued at almost three times the loan's principal and almost twice the tax-assessed value. The borrower has not missed a mortgage payment since moving to the house/farm 26 years ago.

Washington might consider measures that buy down FCS interest rates to get this major rural lender back in the game.

Lenders are requiring between 20 to 50 percent in down payment on bare-land loans, coupled with comparatively high interest rates, adjustable rate mortgages (ARMs) and short terms. One broker who wanted anonymity worried that the "…land banks and farm credit coops are instituting ARMs, which, of course, were one of the major factors in the residential crisis."

I see no defensible reason for loading land loans with this baggage where borrowers present a reasonable plan for the property, qualify for a loan and present sufficient collateral and cash flow.

Since sale of property is a major economic engine in all of our 2,000-plus non-metropolitan counties, these areas would benefit by getting mortgage money out the door, not just into the lender's hands. Washington might consider the following ideas to get rural credit unstuck:

**Encourage/require/reward lenders for holding mortgage notes in their own pockets.** This produces quality lending. It's the opposite of the subprime-derivative explosive device that burned us last year and scorches us still.

**Encourage/reward lenders who make (not just offer) long-term, fixed-rate mortgages (FRMs).** Most borrowers pay these off short of the full term, which means that the lender's front-loading of interest produces a much higher actual interest rate (profit) than the advertised APR. Given the near-inevitability of inflation, FRMs help borrowers build wealth. ARMs are far riskier for individuals and the country as a whole.

**Stop penalizing buyers of small tracts of rural land with inflated down-payment requirements and jacked-up interest rates.** Most land loans under a couple of hundred acres to individuals (not developers) are no riskier and no less liquid than residential loans to the same individuals. The current premium charged on land loans is a form of self-interested price-fixing…in my self-interested opinion.

**Spread the stimulus.** If Washington is trying to goose the housing economy, why exclude sales of existing second homes and second-home bare-land sales from the incentives extended to buyers of principal residences and first-time owners?

**Public option.** I've heard a number of explanations for the lack of financing and high interest rates on rural property in the face of mortgage money at record lows. These explanations -- more risky, less liquid, harder to evaluate -- are either outdated or unsupported from what I can determine. The same lenders who inflated the mortgage bubble with a lot of Wall Street shake and bake are now sitting on the money that's available to them, many like catatonic hens.

The Federal Reserve is making money available cheap, but it's not pushing the lenders to make sensible loans on reasonable terms to responsible borrowers. One lender said that "Bush and Obama seem to have saved us so that we can thumb our noses at borrowers."

If mortgage money costs one percent, might not a public option lend it out at four percent and make a profit? Might not this profit opportunity stimulate competition? And when the market resets, the public option could be put back in its holster.

President Obama reports that our rate of economic decline has slowed. This is better than several of the alternatives.

If he wants to crank the economic-development engine in rural America, he needs to remind lenders that they are lenders. Wasn't that why taxpayer money was used to rescue the system? Am I forgetting something?

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