

Hall and Hall | 2014 Year End Report

BY MIKE MCDONNELL, ARA

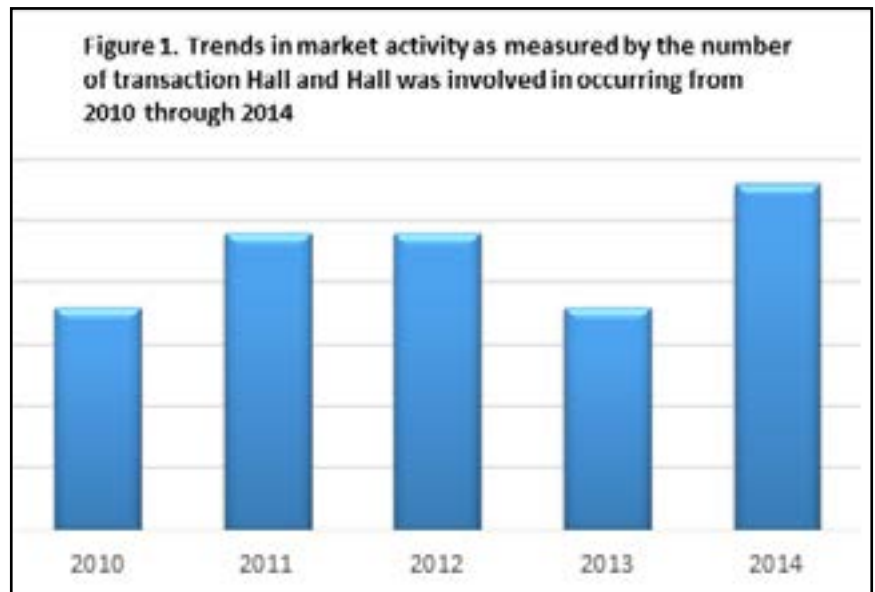
With 2014 just ended, I have been asked to pull together the numbers and analyze the real estate market from the view point of Hall and Hall's Appraisal Group. But first, a brief comment regarding what went on within Hall and Hall during 2014. There were two basic themes that dominated the year. First of all it was a record or near record year for all Hall and Hall divisions with the real estate sales, management groups continuing good trends, and the appraisal and loan divisions staging a strong comeback. The second theme was one of expansion and measured growth with the addition of four new partners and multiple affiliates across the U.S. We coined the term "investment-quality rural real estate" – wherever it might occur - and we continue to pursue that niche with business in 2014 spread from Florida to Oregon and Montana to Texas.

MARKET ACTIVITY

Similar to the record run in stocks, brought on in part by an improvement in the U.S. economy and federal monetary policy, real estate prices continued to see positive momentum through 2014. Nationally, the livestock sector flourished as record low cattle numbers, increased demand and lower corn prices led to historic price levels. As a result, many cattle producers across the country have both the financial ability and the desire to expand.

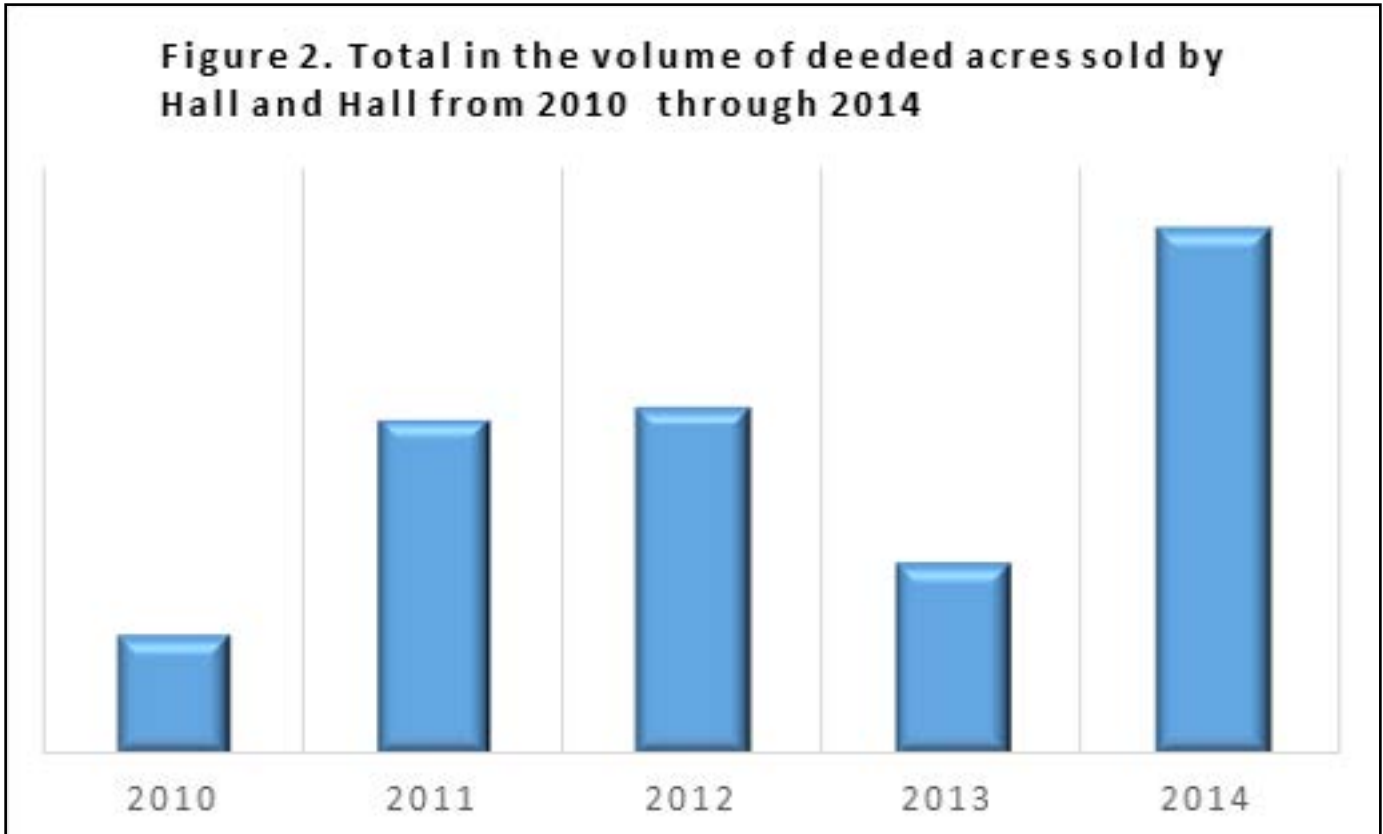
From a historical perspective, the contraction in the general economy experienced in the latter half of 2008 reduced market activity well into 2010. Led by the surge in Midwestern cropland prices, market activity increased from 2010 to 2012, with a decrease in market activity being experienced in 2013 (Figure 1). This decrease was not an indication of demand, which was strong, rather it was a reflection of supply constraints.

While still below the record numbers that occurred in the peak years of 2004/2005, the number of transactions occurring in 2014 increased nearly 60 percent from 2013, as shown in Figure 1.



Increased interest from outside investors, coupled with demand from producers wishing to expand, continued to strain the already tight supply of quality properties in 2014. The combination of these supply-and-demand elements has, in many areas, steadily pulled land values up.

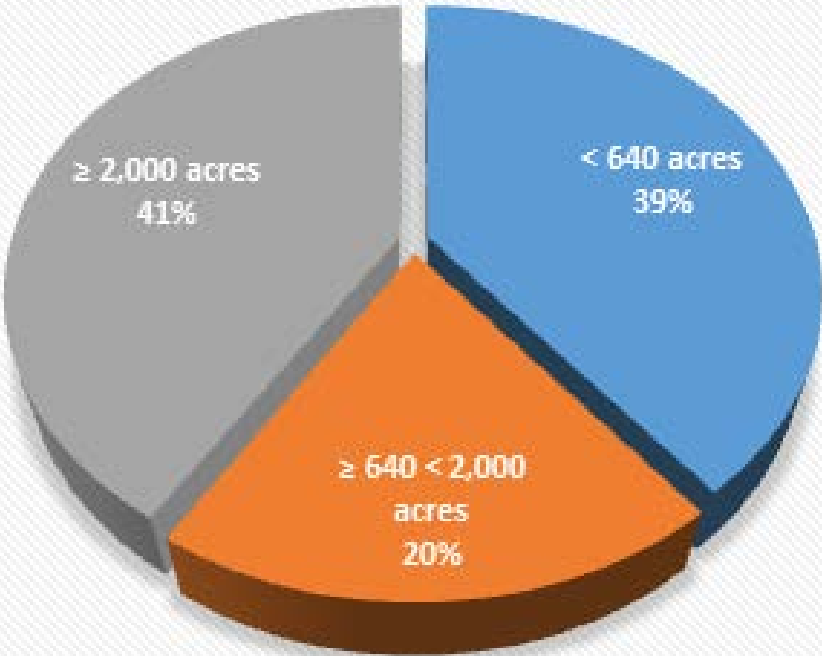
With forty-one percent of 2014 transactions involving properties 2,000 acres in size and greater, the increase in market activity was accompanied by a nearly twofold increase in deeded acreage sold in 2014. As shown in Figure 2, the volume of deeded acreage sold in 2014 is well above the previous four years. Additionally, it is interesting to note that deeded acres sold in 2014 actually exceeded acreage sold in 2004 and 2005, considered by many to be the peak years.



With the speculative investment market nearly nonexistent, properties are generally being purchased as a long-term investment. Larger tracts with good recreational features capable of sustaining viable agricultural operations have drawn increased interest. The combination of increased income and few viable investment alternatives has tended to make owners reluctant to sell, creating additional supply constraints. With larger acreages in short supply, 2014 at times saw the assemblage of multiple parcels into a single unified property. This was somewhat of a reversal of trends experienced prior to 2008 when larger properties were often acquired for speculative purposes with smaller tracts being spun off and re-exposed to the market.

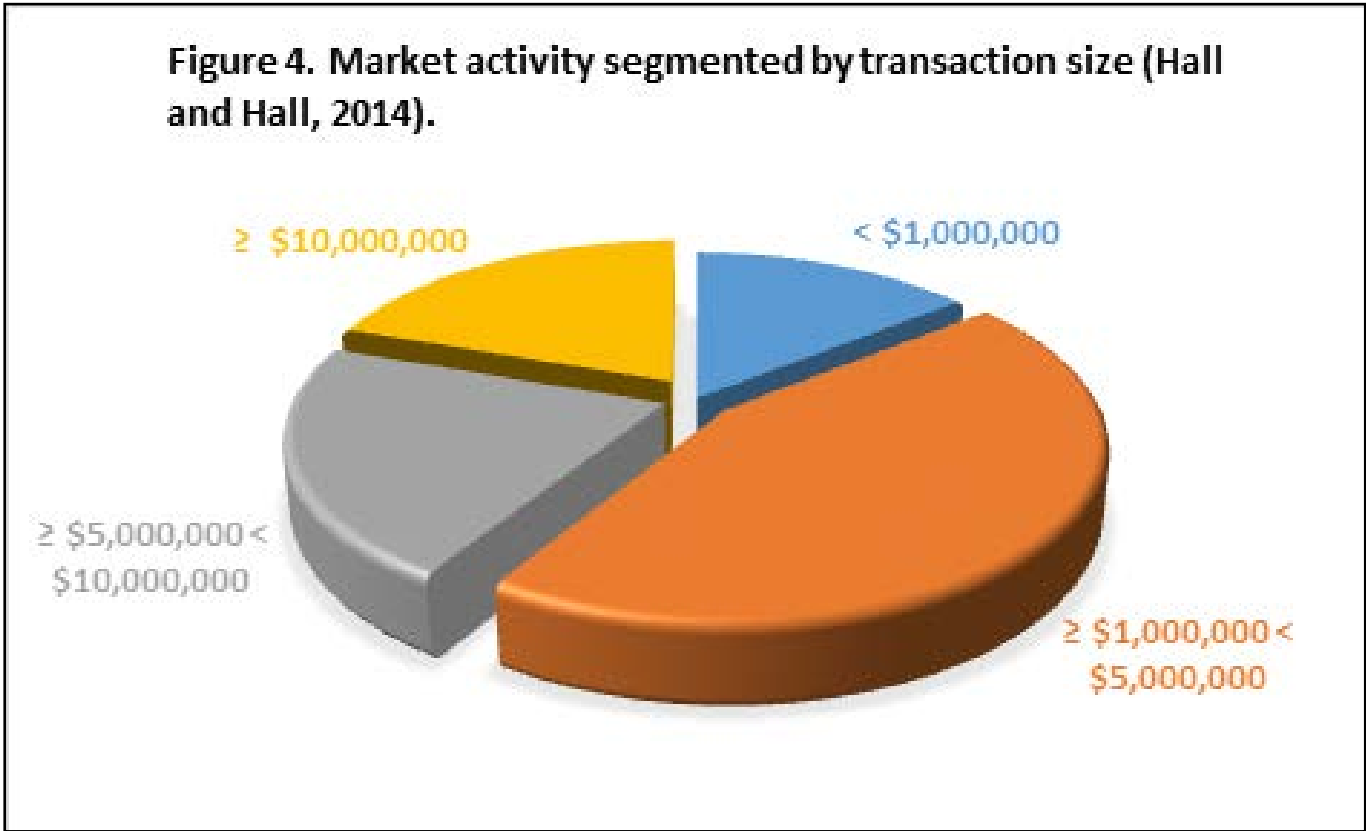
The market for small to mid-sized rural tracts in 2014 appeared to be rebalancing as seller's expectations began to come in line with buyer's price sensitivity. Smaller add-on tracts, especially those with productive irrigated lands, drew increased interest as area producers expanded their production capabilities, which has led to more competition for available tracts. The dynamics of the market in 2014, based on size, are summarized in Figure 3. Small tracts (less than 640 acres) made up less than forty percent of the market, while mid to large-sized tracts (640 acres and greater) represented over sixty percent of the total market.

Figure 3. Market activity segmented by property sized, based on deeded acreage (Hall and Hall, 2014).



As economic conditions improved, the recreational investor began to reemerge in 2014. Properties with premier recreational features or those located in areas with limited private ownership drew the greatest interest. Compared to the past, these non-ag/recreational buyers tended to be better informed, more selective, and more in tune to area markets. Nevertheless, in select cases of high quality properties in the \$2 Million to \$10 Million price category, buyers have been forced to “pay up” for sought after features creating something of a bifurcated market where very high quality desirable properties are changing hands at almost pre-2008 levels while less desirable properties are still being significantly discounted.

As the market in 2014 continued to be dominated largely by production factors, the operating capacity of a property had an increasing effect on purchasing decisions. Sales prices averaged roughly seven to eleven percent below list. Roughly forty-five percent of the market was made up of transactions that ranged from one to five-million dollars in size (Figure 4). However, the next two categories - five to less than ten-million-dollars, and ten-million-dollars and greater - accounted for forty-one percent of the transactions (21 and 20 percent respectively).



OUTLOOK

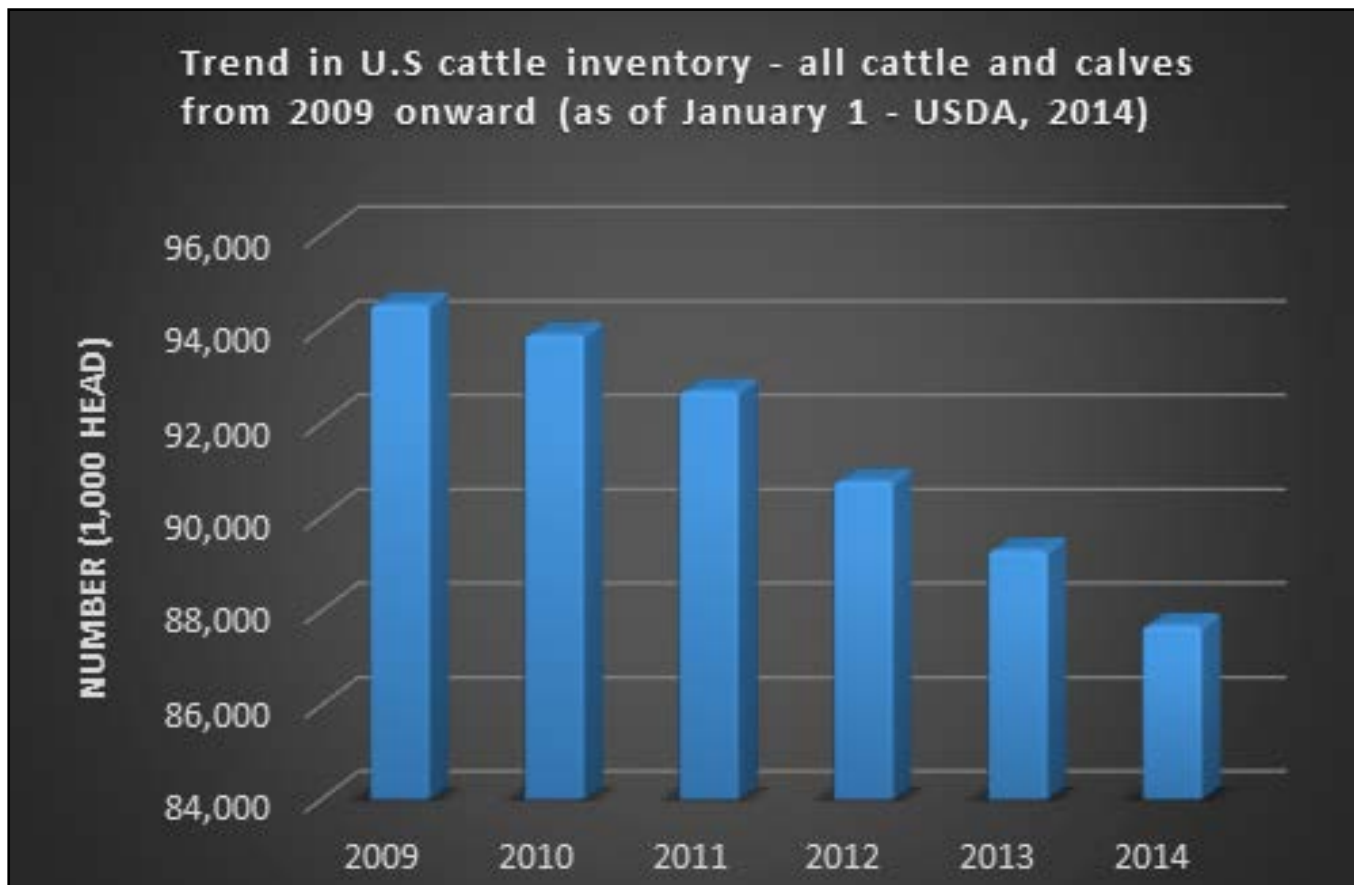
While well below the historic levels reached in 2013, at more than \$113 billion, the 2014 net farm income forecast remains above the previous 10-year average. However, a softening in farmland prices was evident with areas of the Midwest reporting a reduction in cropland prices in the third-quarter of 2014. Declining crop prices are expected to strain farm incomes and slow or stop the trend of increasing farmland prices generally experienced since 2009. Cropland prices have generally benefited from low interest rates and high commodity prices. Both of these factors are expected to move in the opposite direction in the upcoming year. While the lower oil prices will help to lower input costs, the trend of increasing cropland prices is generally expected to continue to slow and possibly reverse itself.

Interest rates are expected to increase in 2015 as the U.S. economy continues to strengthen. The traditional income capitalization model tells us that the price of farmland is a function of the current income derived from the land as compared to the opportunity cost of capital. An increase in interest rates will cause a decrease in

land values as yield expectations will go up. The historically low interest rates experienced in recent years has caused investors to settle for a much lower return on a farmland investment which had the effect of pushing land prices higher. This trend is expected to reverse as interest rates increase.

Tight supply has generally created steady appreciation and positive price momentum in the market for quality working ranches through 2014. A continuation of this trend is expected as interest in available properties remains high.

Nationally, cattle numbers have declined steadily over the past several years with the U.S. cattle inventory reaching historically low levels. This combination of limited supplies and growing demand for beef caused both by improving economic conditions and a burgeoning middle class in the BRIC countries and other emerging markets is expected to push cattle prices even higher. This will pull on an already tight supply of quality ranches in 2015. Demand from outside investors has remained steady and increased earnings will make current owners reluctant to sell, all of which adds up to additional supply constraints. The combination of these factors points toward upward pressure on ranchland prices for the foreseeable future.



The economic downturn that began in 2008 reduced the pool of buyers for scenic retreat properties and caused many owners to be forced to put these properties on the market. While sales of this category remain well below the levels experienced prior to the economic downturn, 2014 saw the re-emergence of the recreational investor. The improvement in the U.S. economy is expected to continue in the upcoming year potentially increasing the pool of

buyers. However, as mentioned previously, compared to past years, these non-ag/recreational buyers tend to be better informed, highly selective and more in tune to area markets. In most cases they will be able to drive hard bargains due to the relatively large inventory of available properties in this category. This is a component of the ranch market that is not expected to reverse itself in the foreseeable future. ■

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Mike McDonnell, ARA
Bozeman, Montana

Mike was raised in Arizona and worked on large cattle ranches in the Western U.S. during his youth. He first came to Montana in 1989 to work as a cowboy. With a desire to advance in the field of agriculture, Mike enrolled at Montana State University where he earned a Bachelor of Science degree in Agricultural Business with an Agribusiness Management option and subsequently a Master's Degree in Animal and Range Science. After graduation, Mike was presented with the opportunity to enter the rural appraisal profession. He began appraising agricultural properties in the Billings area and soon relocated to the Gallatin Valley. Mike comes to Hall and Hall with knowledge in rural real estate and appraisal which has been acquired in a relatively diverse market area. Mike's experience and knowledge will continue to build Hall and Hall's appraisal capability. He holds certified general appraisal licenses in Montana and Idaho and is an accredited member of the American Society of Farm Managers and Rural Appraisers. He is currently working towards his MAI designation with the Appraisal Institute. He resides in Willow Creek with his wife Chelsey and their son where they continue to enjoy rural life. His other son is proudly serving his country in the US Army.

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