



Land Facts

THE LORANDA GROUP, INC.

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AGRICULTURAL REAL ESTATE BROKERAGE, AUCTIONS, ACQUISITIONS, AND CONSULTING

The Loranda Group, Inc. is a diversified agricultural services firm headquartered in Springfield, Illinois and licensed throughout the Midwest. The company offers personalized, professional services in agricultural real estate brokerage, auctions, acquisitions, and consulting. Land Facts is published periodically. We welcome your comments and questions, or give us a call if you would like to discuss the farmland market in your particular area.



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What To Expect From Your Farmland Investment in 2004

By Douglas L. Hensley

Buy low, sell high—it's the mantra of any investor in every market. Yet, the importance of timing—knowing when to buy and when to sell, plays a critical role in the success of the investment decision. Every market has its twists and turns, and the farm real estate market is no different. So, if you want to know how to capitalize on the farmland market in 2004, it will be advantageous to know what you can expect—whether you're a seller, a buyer, or both.

For the Seller...

No one, including the most experienced real estate professionals, has ever seen a farm real estate market quite like we currently have. Perhaps they've seen similar prices, but not with the same underlying fundamentals. Simply put—strong demand has continued to propel prices upward. In many areas of Illinois, land values have surpassed the previous high values seen in the late 1970s and early 1980s. According to the index of average farmland sale values tracked in the *Illinois Land Sales Bulletin*, farmland values since July 1986 (the bottom of the cycle), on average, have now more than doubled. In compounded interest terms, the values over this period have increased by more than 4% annually. And what is equally amazing, the value index does not include any of the annual cash returns generated from the land! When you add in the average annual cash returns generated by the value of farm production, land investments *over this period* exceed the returns from most alternative investments.

All of this begs the question—knowing what we do about previous land market cycles, is now the time to sell some or all of your land holdings and cash in your profits? If you've been watching land sales recently, you already know that it is a "seller's market." So what can you expect in 2004? As an investor-owner in this environment, you can anticipate receiving prices near their historic highs, while still maintaining some control over who farms the property in the future. This ability to control tenancy assumes an investor purchases the land—however, in most areas

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Recreational Land: *A Unique Type of Real Estate Investment*

By Eric L. Sarff

Over the past few years, a new niche has been formed in the agricultural real estate market—recreational real estate. What is recreational land and how is it different from traditional agricultural land? In simple terms, recreational land is real estate that isn't being tilled or grazed, and land that isn't going to be developed in the foreseeable future. This non-tillable acreage could be timber, a pond, or acreage enrolled in government programs. While tillable acres offer the owner an opportunity to receive income from a property, recreational property offers a variety of activities from hunting to fishing to the potential for a weekend retreat. For many, owning recreational land is simply a means to enjoy their outdoor hobbies, really no different than the person who likes to golf in their spare time.

For current owners of recreational land, it's important to understand that this non-tillable acreage now has real value. That's a change from the old mind-set that if it can't be cleared and farmed, it can't be worth much. The value for this type of real estate is generally maximized when the property is offered for sale in smaller parcels, from 40-100 acres. This size of tract is affordable for many outdoorsman, especially with today's low interest rates. Additionally, with recreational property, there seems to exist an imaginary threshold where a buyer views anything under 100 acres for its entertainment value, and not for its investment value. Once the 100-acre threshold is crossed, buyers not surprisingly take a property's income into



consideration. If a property is over 100 acres it can still be very marketable, but generally it helps to have acres that can produce yearly income (row-crop or CRP land), along with the recreational acreage. Another important number to keep in mind is 40, or the number of acres a person must own before they are automatically eligible to receive a deer hunting shotgun permit in Illinois. In popular deer hunting counties, where permits are limited and difficult to obtain, the ability to get a landowner's permit is a right that can add significant value to the property.

Recreational land has now evolved into a major component of the agricultural real estate market because it offers different opportunities for different buyers. Let's consider what we call a combination property—a property with both tillable and recreational features. This hypothetical property consists of 100 acres, with 40 acres in row crop production, 30 acres in the government Conservation Reserve Program (CRP), 25 acres in timber, and a 5-acre pond. For the hunting enthusiast, the timber and CRP acres offer bountiful hunting opportunities, from deer and turkey hunting to pheasant and quail hunting, and everything in between. The income

from the tillable and CRP acres will provide an annual income stream that can help pay the real estate taxes and any mortgage payments. For the buyer looking for a place in the country to build a weekend retreat, the acreage around the pond can offer a beautiful home site. And for the buyer looking at the land strictly as an investment, this property offers many different sources of cash flow. The owner can receive income from the acreage enrolled in the CRP program and from the tillable land. In addition, income can be generated from leasing the hunting rights on the property (which, will vary from region to region). Thus, the owner can receive income from virtually all of the acreage, thus enhancing his or her overall return.

As mentioned above, the market for recreational real estate is extremely active at the present. The growing number of people interested in outdoor activities, coupled with higher disposable incomes and lower interest rates, has fueled a great demand for recreational land. All of these factors have created a new niche in the land market where landowners can receive a reasonable rate of return while enjoying the many extra benefits that recreational land can provide.



Welcome Eric Sarff

Eric Sarff recently became a sales agent for The Loranda Group, Inc., where he specializes in recreational property. Prior to joining the Loranda Group, Inc., Sarff was involved in many diverse activities, including being the assistant manager for a very successful duck club near Havana, IL, and selling recreational property for Kennedy-Sarff Real Estate, LLC.

Sarff was raised on a cash grain farm in west-central Illinois. It was here where he developed a passion for hunting and the outdoors. Eric is a graduate of the University of Illinois with a Bachelor of Science in Agricultural Finance. His experiences and his education allow him to quickly and effectively analyze the recreational land market.

In providing value to The Loranda Group, Inc. and its clients, Eric brings a wealth of knowledge and expertise. Sarff is an avid lifelong hunter and is a member of numerous wildlife preservation societies, including Ducks Unlimited and White-tails Unlimited. Sarff's unique background will allow him to effectively assist both buyers and sellers of this unique type of real estate.

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investors have been the most aggressive buyers. Why is the current tenant so important to many landowners? Because they are concerned about how the sale of their property could impact the welfare of their operator. If they know that the present tenant has some opportunity to continue operating the land in the future, then they are more willing to divest of their holdings. And a sale to an investor with a leaseback to the current farmer is a winning scenario for all parties. For farmer-owners, the situation is similar—receive a great price *and* retain the opportunity to leaseback the land. This can potentially clean up some amount of debt without giving up land base—a very attractive alternative.

For the Buyer...

For the potential farm buyer, I'm sure you now think that it would be hypocritical for me to say that you should be buying any tracts you can find. But the ultimate financial success of buying land hinges completely on your expectations for the future. Will

farmland values continue their steady march up? Will supply of high quality farms continue to be limited? Will interest rates stay at these low levels? Will cash buyers continue to dominate the marketplace? It is tough to definitively answer any of these questions—but in the near term there is little reason to believe that much weakness exists in the farmland market. And remember—the 1980's land value collapse was predicated on high debt and quickly rising interest rates. There was rarely a "cash buyer" in the late 1970's and early 1980's land market like there is now.

The current reality for land buyers is that prices are rising and R.O.I.'s are shrinking. If you're looking for top quality land, it's nearly impossible to find a parcel that will generate a 5% annual net cash return. And, as with all investments, the appreciation potential for the farmland asset is difficult to predict. But positive signs for buyers do exist in this market. As mentioned earlier, we know that land values have increased for the past 18

years at an annual rate of more than 4%, on average—and if the current fundamentals stay in place, a continued increase in values is certainly possible. For the investor buyer, competition from farmers looking to expand their operations means you can expect to find a high quality tenant and competitive rental rates. Specifically for the farmer buyer, purchasing a neighboring farm may be feasible, as it's most often worth more to you than anyone else. Doing so assumes that you can add the tract to your operation without it adversely affecting your overall cash flow. But right now, you also have the ability to lock-in commodity prices at a profit, and to cover some amount of risk through the use of insurance—so being aggressive may make sense. And it's worth mentioning again—with the amount of cash flowing **into** the land market, I do not know of anyone who expects a collapse of land values like that seen in the 1980's, where the ability to *borrow money easily* led to the run-up in land values.

Conclusion

The farmland market shows no sign of cooling down. Sellers can generally expect to receive higher prices than ever before, with the potential ability to dictate future lease terms. Buyers can expect tough competition, and higher purchase prices. But who's to know what the future holds? If a landowner has cash needs in the near future, then now may be a great time to liquidate their investment. Or, if a potential buyer believes that the returns to farmland for the next 18 years will be as good as they have been for the past 18 years, then a purchase may be warranted. In real estate, no two properties are identical, and neither are the ownership objectives of the people who buy and sell the land.



The Real Estate Corner

In this issue of *The Real Estate Corner*, we'd like to discuss some common terms that you may have read or heard about in auction sale scenarios, but perhaps you weren't quite sure what they meant, or what their possible repercussions may be to the success of the sale.

“With Reserve“ vs. “Absolute” Auctions

This subject of *auction type*, and the fundamental differences between the two alternatives, is a source of common confusion among buyers and sellers. At a “with reserve” auction, the seller retains the right to **accept** or **reject** the final bid at the sale. And unless specifically stated to the contrary in its advertising, the law states that every auction is considered “with reserve.” However, if an auction is advertised as “absolute” or “without reserve,” the rules are different. In an absolute sale, the seller agrees to sell the property, regardless of sale price. Legally with this type of auction, any lien holders must also agree in writing to the “absolute” concept. With farm real estate, it's most common to see “with reserve” auctions. However, “absolute” sales do occur in the Midwest, and they can

signal to the market that the seller is highly motivated. There are other rules that are specific to each type of auction (see seller/auctioneer bidding paragraph below). When in doubt, contact the auction company or your attorney in advance so you know what to expect before bidding begins.

Buyer's Premium

Another evolving issue relative to auctions is who pays the auctioneer's commission. Historically, at least in the agricultural community, sellers have paid the auctioneer's fee. But this does not always have to be the case. In certain situations, it may be prudent to have a *buyer's premium*, where the buyer pays an additional fee (normally a %) on top of their high bid amount. Generally, the buyer's premium is used to pay for more than just the auctioneer's commission—it also is applied to any advertising, surveying, or other closing costs that the seller may incur. In certain markets including antiques, art, real estate “trophy properties,” and industrial equipment, the use of a buyer's premium is fairly standard. In others, including most Midwestern farm equipment and farmland auctions, using a buyer's premium could adversely affect the sale, especially if bidders don't understand the concept. Regardless of your opinion of a buyer's

premium (and auctioneers have debated the topic as much as buyers and sellers), it's becoming more popular and something you may see at the next auction you attend. And, just like the auction type issue discussed above, if an auction includes a buyer's premium as a term of sale, it must be plainly disclosed in any sale advertising.

Seller/Auctioneer Bidding

A final topic that generates a great deal of conversation (and acrimony) among buyers and sellers, involves bidding by the seller and/or bidding by the auctioneer for their own account. Simply stated, the law allows sellers to bid on their own items being offered at auction, *if full disclosure* is given to the buying public before any bidding begins. The exception to seller bidding occurs with an “absolute” or “without reserve” auction. With this type of sale, in most jurisdictions, sellers or their representatives may not legally bid on their own property. *Undisclosed* seller bidding is illegal in all situations and potentially warrants a lawsuit. Bidding by an auctioneer for himself is legal in most states, though many believe it is unethical and destroys the integrity of an auction. Others say that if full disclosure is given, there is nothing wrong with the practice. Again, you will find it quite helpful if you understand the rules of the auction before you start bidding, or the policies of an auctioneer that you're ready to hire, to avoid any possible controversies that may result in a lawsuit.



Be sure to check out the “Properties for Sale” link on our web site for current real estate listings and upcoming auctions: www.loranda.com