# Land Facts

THE LORANDA GROUP, INC.

*Spring* 2005

In this edition...



**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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## Will Another Investment Bubble Soon Burst?

*By John D. Moss*

Let's consider an investment characterized by the following economic conditions:

- Prices are at record levels;
- Interest rates are beginning to rise;
- Purchases can be (and are being) made with nearly 100% financing;
- People are aggressively buying because they know that prices will continue to rise and their asset will be worth much more in 6–12 months.

Most farmland historians would recognize these conditions as the primary factors that caused the increase, and ultimate decline, in farmland prices 25 years ago. Fortunately, most people involved with farmland today (buyers, sellers, lenders, etc.) recognize and remember what can happen when greed and "certainty" can overtake common sense. Yes, land prices are at all time highs today and interest rates are beginning to rise. But the era of 100% financing and speculative buying is long gone. Thus, the market can survive a minor correction, if necessary. However, I do see one type of investment today that can be characterized by all of the economic conditions listed above. That investment is residential real estate.

Does the current residential real estate market really fit the economic profile outlined above? Let's look at each factor one by one:

**High Prices** • Home and lot prices in nearly all areas of the U.S. are at historically high levels. According to the National Association of Realtors, the national median home price in 2004 was $195,000. In 2000, it was $139,200.

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# The Real Estate Corner

The recent increase in gasoline prices, initiated by the run-up in crude oil prices, has caused many people to pay closer attention to the value of the natural resources underlying land assets around the globe. On the whole, most people we speak with know little about their rights regarding mineral ownership. To help clarify some of the major concerns that an owner may have, we talked with an attorney who regularly deals with the issues surrounding minerals.

### *What exactly are minerals?*

The natural resources under the surface of the earth can be collectively called minerals. Fossil fuels (natural gas, oil, coal), metal-bearing ores (gold, iron), and non-metallic minerals (limestone, gypsum, salt, gravel, sand) all qualify. In the U.S., unlike many nations, the rights associated with underground minerals are part of the entire "bundle of rights" held by the surface owner. As a result, the property rights governing minerals can be *severed* from surface rights. By definition, a *mineral right* is the right or title to all or specified minerals in a given tract; or the right to explore for and extract such minerals, or to receive a royalty for them.

### *If minerals can be severed from surface rights, how does the separation occur?*

This distinct set of rights can be separated from surface rights in several ways—by a mineral lease, mineral deed, or by reserving the rights, in whole or in part, when an owner sells the surface rights to a parcel.

### *Is water a mineral that is treated like coal or oil?*

Not necessarily—water involves special rights designed to govern it, known as *Riparian rights*.

### *Are certain minerals always severed from a surface interest by deed, while others are leased?*

Again, not necessarily. While there are norms in each industry (for example, most oil interests are leased to oil exploration companies), every situation is different and there are no absolute rules for separation, per say.

### *What's the difference between leasing and deeding mineral rights?*

In a lease scenario, the lessee does not own the mineral rights, but rather is paying a fee to the surface owner (normally in the form of royalty) for the right to explore and extract. Mineral leases often spell out what *types* of minerals can be extracted; to what *depth* the minerals may be extracted; for what *time period* the lease is valid; and what *compensation* the owner may possibly receive. On the other hand, mineral rights can also be deeded away, where the surface owner is paid a flat amount for giving away the rights of future underground mineral development/ extraction on a parcel of real estate.

### *Assume you own land where drill exploration is occurring and you hit—how do you know that the mineral reserve is under your land and not partially on your neighbors land?*

You don't! And that's why soon after you discover the presence of the resource under your land, your neighbors will likely be out establishing wells on their land, hoping to duplicate your success.

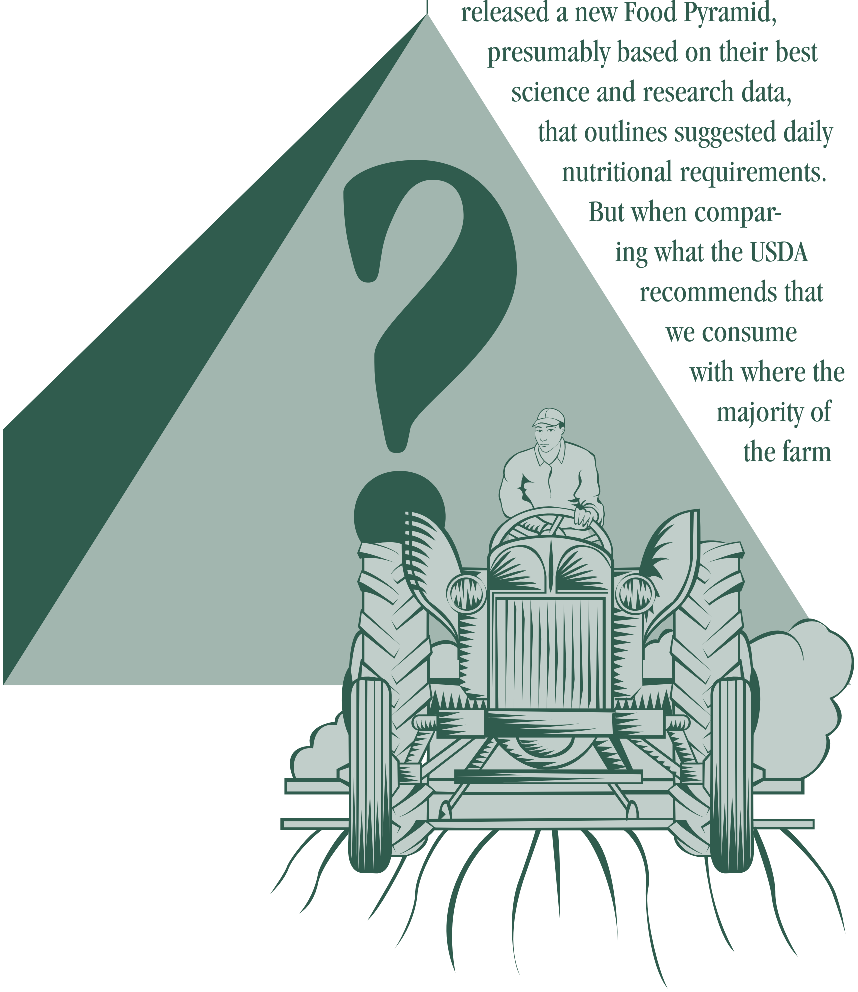
In conclusion, the key for landowners who are considering severing their mineral rights or beginning exploration, is to become informed with the possible consequences of or requirements in doing so. For the real estate buyer, part of the due diligence process involves determining whether the mineral rights of the parcel are intact, in whole or in part. Previous mineral right reservations, like most title issues, are part of the public record and can be researched at the county offices where the parcel is located. If you have a question that involves mineral rights for your land holdings, it is advisable to consult with an attorney who has experience in handling transactions involving these types of matters.

# The Farm Program vs. The Food Pyramid—A Case of Inconsistent Policy?

*By Douglas L. Hensley*

Over the past several years, one issue that has been discussed in each farm bill debate is the concept of a "Cheap Food Policy." The rationale is that farm subsidies are good for the United States as a whole because they lower our food costs. This cheap food policy concept has even been discussed as a matter of national security. But how does the Farm Bill really benefit the American consumer? What kind of benefits does the average taxpayer receive? Is it good food/agricultural policy, or is it just good politics? More importantly, are current farm subsidies consistent with *other* USDA policies?

Earlier this year, the government released a new Food Pyramid, presumably based on their best science and research data, that outlines suggested daily nutritional requirements. But when comparing what the USDA recommends that we consume with where the majority of the farm subsidies are flowing, a real disparity emerges.



The bulk of farm program payments go to support six major crops—corn, soybeans, wheat, cotton, rice, and sugar. Those of us involved in agriculture know that these crops are ultimately used in 1 of 3 ways—for livestock feed, for processing into products like oils and sweeteners, or for outright export. Thus, a large percentage of these program crops are consumed by U.S. citizens as either: (1) meat products, which we are now encouraged to eat sparingly (5½ ounces per day); or (2) in sweeteners/oils or other highly processed foods, which the average U.S. consumer is encouraged to eat *less of* because of potential unhealthy consequences like obesity, diabetes, etc.

Many economists, nutritionists, and columnists are beginning to question whether this makes any sense. On the one hand, the USDA is telling us that the big six crops are important, because that's where they focus our Farm Bill dollars. But on the other hand, they are telling us to closely watch our consumption of the products that many of the big six are used to produce. Foods we are encouraged to consume more of, like fruits and vegetables, have not generally been included as program crops and thus receive no direct payments. It's definitely an inconsistency that USDA will need to balance, both internally and publicly, before the next Farm Bill is finalized.

*Will Another Investment Bubble Soon Burst?, continued from page 1*

**Interest Rates •** In the last few months, the Federal Reserve has raised short term rates by 2%, which has minimized the attractiveness of the adjustable rate mortgage (ARM), a previously popular financing tool. With our current national deficit rapidly increasing and inflation (driven by oil prices) on the rise, most economists believe that both short and long term interest rates will continue to go up.

**Financing •** The ability to buy a home today with almost no money down has helped fuel record home prices and sales. A newer and potentially troubling mortgage product—the "interest only" loan—has also helped home sales. However, when someone chooses to only pay the interest each month, then the ability to build equity in a property is strictly limited to inflationary increases in value. But what if prices don't go up, or what if someone has to move (and thus incur closing costs) that are far greater than the appreciated value of their home? The result is what the industry calls being "upside-down," or owing more on a property than what it is worth. In conversations with many residential brokers, this upside-down scenario is becoming more common every day.

**Speculative Buying •** A recent report by the National Association of Realtors indicated that nearly one-third of all homes in 2004 were purchased by *non owner* occupants. There is no doubt that many people can now afford second homes. But unfortunately, there are far too many who are buying today simply because they think these properties will be worth 20–30% more next year, as has been the case in Florida, Arizona, California, and many parts of the east coast.

One might wonder how the residential real estate market may affect the farm real estate market. As we've discussed in previous editions of *Land Facts*, as developers buy raw land for new subdivisions, the sellers of this land are completing 1031 exchanges and aggressively buying farms to avoid the capital gains tax. If the market for homes in certain areas becomes unstable or overbuilt (and thus new developments stop), then many of the people currently buying farmland would no longer be looking for replacement property. As such, the farmland market and the residential market are indirectly linked.

In summary, let me state that I do *not* believe that the entire residential real estate market is about to collapse. However, in certain areas of the U.S. I see real trouble brewing—too much speculative buying coupled with too much borrowed money. Hopefully, our friends on the residential side will learn from the mistakes of their farm real estate counterparts before it is too late.

# Loranda Opens Indiana Office

The Loranda Group, Inc. is pleased to announce the opening of an office in Lafayette to serve its expanding Indiana real estate client base. This location will offer brokerage, auction, and consulting services.

The new office will be managed by Larry Skiles. Larry was raised on a farm in Central Indiana where he developed an interest in agriculture and an appreciation for farmland as a natural resource. He is married with three children and is quite active in community activities. Larry's ability to analyze farmland from both a productivity standpoint, and as an investment, will appeal to both farmers and investors. He can be reached by telephone at 1-800-716-8189, or by email at larry@loranda.com.