Beckner & Associates, Inc.
Commercial Real Estate Services

Should I Invest in Land?

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A land investment can be one of the best real estate investments available. But, it also can be one of the hardest. Most investors are not able to invest in land. But, those who can will often earn significantly higher returns than are available with other investments.

Land is development through several different stages. Each stage results in a higher value than the previous stage. Land begins as raw farm ground and its value is based upon the crops its can produce. As cities expand they develop a Comprehensive Master Plan which shows the desired future use for each area of the city. It will designate single family and multi-family sites. It will also show office and retail areas which are close to the residential areas. Industrial uses will be segregated from the others. The planned use will be greatly influenced by the existing and proposed highway and street systems. The cities in the past have generally had a flow from residential to office to retail. Multi-family and office were used as buffers between residential and retail. This progression is still used in most cases. But, recently, this progression has been altered in some areas to the “New Urban” approach. This approach allows the various uses to coexist as they did in the past in the city’s center. Understanding this progression and the street/highway system is crucial to land investment.

As development in an area grows a developer/investor purchases the land and develops a master plan for the area. The vast majority of the land will be used for residential uses, but, higher uses will be introduced. Retail will be proposed on the corners of major intersections with the other uses wrapping the proposed retail. Different uses will vary greatly in value from apartment ground being the lowest to retail the most expensive. The developer/investor will seek city approval for his plan which will specify the areas for each use. The city will rezone the area to match the approved plan.

Once the land developer/investor has received approval and rezoning for his plan, he will then market the various sections to other developer/investors who specialize in that particular segment. A developer/investor rarely works in more than one specialty. The new developer/investor will then either move forward with the construction of that area or he will further subdivide the land into smaller parcels. A pad site is worth much more per square foot than a larger retail parcel.

The land investor makes his money by holding the property waiting for the property to be ready to move from one phase to the next or serving as developer and attempting to take the property to the next phase. The more phases the investor moves through the greater the return on his investment. This is the major problem with land investment. No one knows how long it will take to move through a phase. Sometimes the process is rapid and the return is significant and quick. Other times the market slows and it takes a very long time for the property to appreciate. Anticipated value increases may be based upon the building of a highway or other development in the area. If these events do not occur, the anticipated appreciation may be delayed or nonexistent. Many investors have had to hold land much longer than anticipated. A good example is land near the Kansas City International Airport. Once the airport was announced the land values in that area shot up quickly in anticipation of rapid growth. But that growth did not occur as anticipated.

Most land investors pay cash for the land. Since they do not have any guarantee of rapid appreciation or a short holding period they do not want to have a mortgage and the resulting cash drain. Banks will loan on ground but will often want as much as 50% as down payment. The government continues to assess the ground and expects property tax payments. These tax payments can increase over the holding period as the city anticipates the increase in value. It is this lack of cash flow that keeps most investors away. As a result land investors are individuals who are willing to take greater risk in anticipation of greater future returns. They generally have no need for immediate cash flow from their investment and are willing to in fact experience negative cash flow.

Another approach to land investment is to utilize the land while waiting for the future appreciation. Examples of this are nurseries, drive-in theaters, driving ranges, etc. These investors make improvements to the property which they feel will be fully depreciated over the holding period or will be more than paid by the cash flow generated by the use. If the land does not develop as anticipated, the investor can continue to run the business and wait for the appropriate time to sell.

Land investment is not for everyone. It has significant risk. But the rewards can be spectacular if the investor has correctly forecasted future growth. They simply are not making any more of it.