What's Driving Land Prices?

Recent weeks have seen heavy involvement with clients grappling with land sale and purchase. The decisions don't get any easier– especially after 25 years telling them they can't afford going prices yet in the same breath advising they can't afford not to buy!

Throughout New Zealand there is intense pressure on land prices and a weak relationship between land price and profit. For example, on my calculations a central Waikato Dairy farm at $35 per kg MS with a target return on equity of 6.5% is about 50% overvalued.

How can this be explained? Are there new ways to rationalise and pick the market trends? These thoughts are about some factors that may be driving the premium. They're not exhaustive but they do highlight the complexity of the issue.

A Beefed Up Rural Economy

Fanning the flames of value growth has to be a historical leap in rural wealth creation over recent buoyant times. These boom years for the Primary Sector have possibly created more wealth than was ever expected. Stable milk prices and positive returns for lamb, beef and kiwifruit have seen all industries regularly exceeding expectations.

This has enabled aggressive debt reduction complemented by investment inside the farm gate for efficiencies and growth that mean many farms are running at optimum. Enhanced confidence and the growth culture of leading operators has seen their appetite for expansion even more strongly fuelled.

Recognition of the relationship between business size and sustainability has been another key driver. It has fired enthusiasm for land purchase and sharpened the incentive for farmers in their twilight years to sell down. The average age of farmers well into the fifties opens the door for amalgamation, delegation and a corporate approach.

Quite simply, there is an extraordinary amount of unsatisfied capital and borrowing potential competing for a limited resource. As importantly, it's not easy to find alternatives that offer the perceived security and potential capital growth of rural property.

Fonterra Share Values

The success of Fonterra is another driver for land prices. Consistently improving share values and anticipated changes in capital structure have potential to motivate the market.

Care is needed to accurately assess the impact of this across the wider land market. There's a risk the Fonterra factor is imported to non-dairy land to the detriment of its value if the share price is unbundled in the long term. So long as the only way to participate in Fonterra is to own Dairy Land, its share value and prospects will remain a factor in land values. Developments in this area need to be closely monitored.

A Slice of Godzone

Finally, to fully appreciate the value of our farms one might be well advised to carry out the review in London, Tokyo or New York. Looking at rural New Zealand from international perspectives is basic to fully understanding land prices.

Consider personal security, climatic advantage, a settled (if not bullish) economy and the lifestyle, expertise and reliability of farming New Zealand. Add to that access to education, our recreational environment, off farm career opportunities and the quality of our work force and it's not hard to see how attractive our farms are as an investment proposition. These are all part of our competitive advantage and naturally translate to value internationally.

Keeping in touch with all of this is fundamental for farmers and their advisors. Getting that extra kilo of milk solids or growing the lambing percentage is important, but not at the expense of wealth creation opportunities in these buoyant times.

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