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Imminent California Legislation Increases Land Valuation Complexity

... but Other Economic Factors Remain Relevant

Roland Fumasi
Senior Analyst

roland.fumasi@
rabobank.com
+1 (559) 447-7961
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After an unprecedented growth rate in California agricultural land values between 2010 and 2015, land prices have since softened. Lower tree nut prices, low capitalization rates for investors, some economically unsustainable land valuations, and rising production costs all play a part, but the impending implementation of California's Sustainable Groundwater Management Act (SGMA) will continue to put additional downward pressure on specific types of property in specific California growing regions, particularly in the San Joaquin Valley (SJV).

The outlook for California land prices depends on the region and specific differences between properties within the region.¹ Generally, land value appreciation is expected to slow – but continue – on the North Coast. On average, Central Coast land values are expected to keep their recent upward pace, but specific locations could see declines. Relatively higher surface water reliability helps support Sacramento Valley land values, but recent, rapid land price appreciation will likely require some downward adjustment. SJV properties will be hit hardest by SGMA, with impact worsening as you move to the south and west.² Southern California properties that have Colorado River water access are well-positioned to navigate SGMA expectations.

Average Coastal & Southern California Land Prices Are Forecast to Hold up Better Than the Central Valley

On average, estimated land value changes from 2017 to 2019 are expected to remain positive for the North Coast, Central Coast, and Southern California regions. Average declines are forecast for all Central Valley regions. Generally, lighter downward pressure is expected in the Sacramento Valley and the Northern SJV, with an estimated average land value decline of 7% in both regions. The deepest average decline is expected in the Southern SJV, at 12%. The average decline in the Central SJV region is expected to be around 10%.

Rise in North Coast Valuations Is Expected to Continue, but at a Slower Pace

Vineyard – and prospective vineyard – valuations have risen significantly in the Napa Valley over the past two years. The unweighted average change between 2015 and 2017 for both Napa and Sonoma combined was 12%. Aside from potential SGMA impacts, vineyard and grape prices have risen faster than wine prices, and interest rates are expected to continue to rise. North Coast property values are expected to rise by a modest 2% on average during the 2018/19 period.

Expected Land Value Changes on the Central Coast Heavily Depend on Specifics

San Benito County property values have risen sharply since 2015, as Salinas Valley growers have invested into this growing region. However, this area relies primarily on wells. While SGMA has apparently not yet had an impact on valuations, this is expected to change as SGMA implementation draws nearer.

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¹ For more information about the impact of tree nut prices and other factors on California land values, see Rabobank's article, *California Agricultural Land Values Outlook 2016: Back to Reality*, October 2016).

² The California Sustainable Groundwater Management Act was signed into law in September 2014. The legislation establishes active management of California groundwater, with the goal of reaching groundwater 'sustainability' by 2040-42. Implementation of Groundwater Sustainability Plans begins in 2020 for critically overdrafted basins. Restrictions on groundwater pumping are likely to occur to varying degrees, depending on the specific circumstances impacting each basin.

Monterey and Santa Cruz County cropland values are expected to be stable to slightly increasing. Open cropland values in San Luis Obispo (SLO), Santa Barbara, and Ventura Counties are expected to remain relatively stable. However, Ventura lemon and avocado properties are forecast higher in the 2018/19 period – despite SGMA implementation and the extension of farmland protection provisions – due to strong crop prices and long-run, multi-generational prospects.

Water Availability Helps Support Sacramento Valley Valuations, but Exceptions Exist

Higher relative surface water reliability will continue to help stabilize Sacramento Valley property values, especially those that have already seen significant declines due to lower crop prices. Westside properties for almond development have continued to be in high demand due to more moderate land prices, but those properties can come with lower water availability and lower soil quality. Therefore, Northwestern property valuations likely need to soften. Rice property values are expected to remain relatively stable through 2019.

Northern SJV Land Valuations Will Decrease at a Slightly Slower Rate

The vast majority of cropland valuations in the Northern SJV were lower during the 2016/17 period. The American Society of Farm Managers & Rural Appraisers (ASFMRA) reports that sales activity slowed in 2017. SGMA implementation and the state's plan to begin taking 40% of unimpaired flows from the Stanislaus, Tuolumne, and Merced Rivers has created an uncertain environment. On average, properties in this region are expected to decline in value by 5% to 10% between 2017 and 2019. For the areas that saw the largest percent reductions in value between 2015 and 2017, declines are expected to slow significantly.

No Surprise: Well-Only and Westside Properties Will Be Most Impacted by SGMA in Central SJV

In the Central SJV, well-only properties as a group have had the steepest declines in valuation since peaking in 2015. Westside properties have also come under pressure. Without

robust access to surface water for groundwater recharge, these properties will be most constrained by SGMA implementation. Lower-quality (more saline) groundwater also limits crop yields. In terms of SGMA, Fresno County District water properties should be relatively more immune to negative impact. But in light of significant land price appreciation between 2010 and 2017, lower crop prices, and rising interest rates, the low end of the range for Fresno County District water properties is expected to come down in 2018/19.

A Slight Downward Acceleration in Average Value Is Expected in the Southern SJV

On average, Southern SJV properties are expected to see the biggest declines in valuation during 2018/19. Westside properties are likely to have the most weakness, but lower commodity prices and economically unsustainable increases in some other land values in the area are expected to lead to a short-run downward adjustment in the value of various permanent plantings. On a positive note, recent steep declines in some land values are expected to moderate in 2018/19.

Much of Southern California Is in a Different 'Waterworld'

Southern California land values have remained relatively stable. Access to Colorado River water insulates much of the growing region from SGMA impacts. A weak processing date market has negatively impacted Coachella Valley date properties, but property values are forecast to stabilize. Overall, the stable trend is expected to continue, with ongoing moderate increases in value.

A Specific Look at Almond Properties

Almond properties were neither the best-performing nor worst-performing between 2015 and 2017, so they are not shown on the following charts. Sacramento Valley almond orchard values stayed at their peaks through 2017, and almond orchard values had their largest declines (-22%) in the Southern SJV. During 2018/19, California almond orchard values are expected to decline by 10% to 15% on average, with the most moderate declines occurring in the Central SJV.

What's the impact?

- **Willing sellers of the highest-quality properties will be in short supply**
- **Willing buyers of the lowest-quality properties will be in short supply**
- **Rising interest rates may require lowering land prices to attract investors**
- **Longer-run outlook for California land values remains positive**

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SGMA Impacts Central & Southern San Joaquin Valley Property Values



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The Sustainable Groundwater Management Act (SGMA) has pressured land values, especially Central Valley areas south of the Delta. Generally, this trend is expected to continue and even accelerate in specific locations.

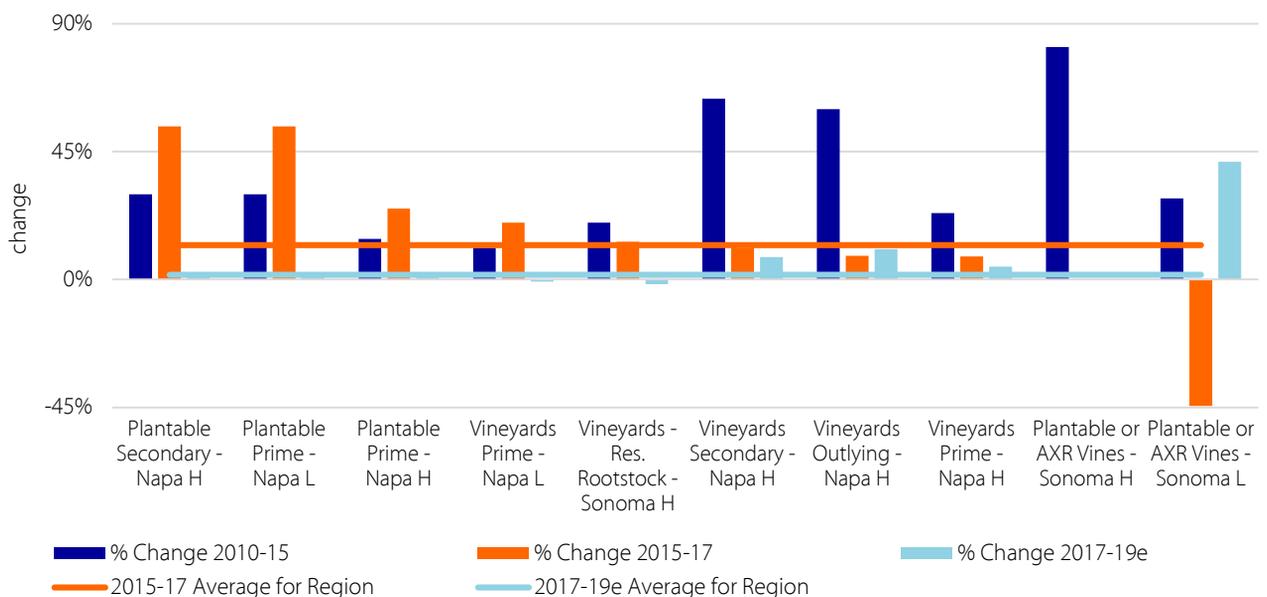
Expected Declines in Average Land Values Increase as You Move South Through the Central Valley^{1,2}

	% Change 2010-15			% Change 2015-17			% Change 2017-19f		
	High-End	Low-End	Mid	High-End	Low-End	Mid	High-End	Low-End	Mid
North Coast	37%	18%	29%	15%	4%	12%	2%	3%	2%
Central Coast	42%	27%	35%	3%	8%	4%	5%	1%	4%
Sacramento Valley	139%	150%	141%	-5%	8%	-1%	-3%	-14%	-7%
Northern San Joaquin Valley (SJV)	77%	86%	79%	-9%	-6%	-8%	-5%	-10%	-7%
Central SJV	158%	130%	147%	-12%	-9%	-11%	-7%	-17%	-10%
Southern SJV	128%	124%	127%	-6%	-8%	-7%	-12%	-12%	-12%
Southern California	42%	42%	42%	2%	1%	1%	1%	2%	1%

Source: California Chapter ASFMRA, Rabobank 2018

North Coast vineyard – and prospective vineyard – property values have continued to rise at an accelerated rate for the highest-quality properties. Value growth is likely to slow as investor activity is hampered by rising interest rates.

Average North Coast Land Valuations Are Expected to Continue Rising, but at a Slower Pace*



* H = high end of the range, L = low end of the range for this, and subsequent, graphs

Source: California Chapter ASFMRA, Rabobank 2018

¹ The terms 'high-end' and 'low-end' refer to the upper end and low end of the land valuation range, respectively, for the specific category of land listed. 'H' and 'L' are also used to identify the high-end and low-end of the range, respectively.

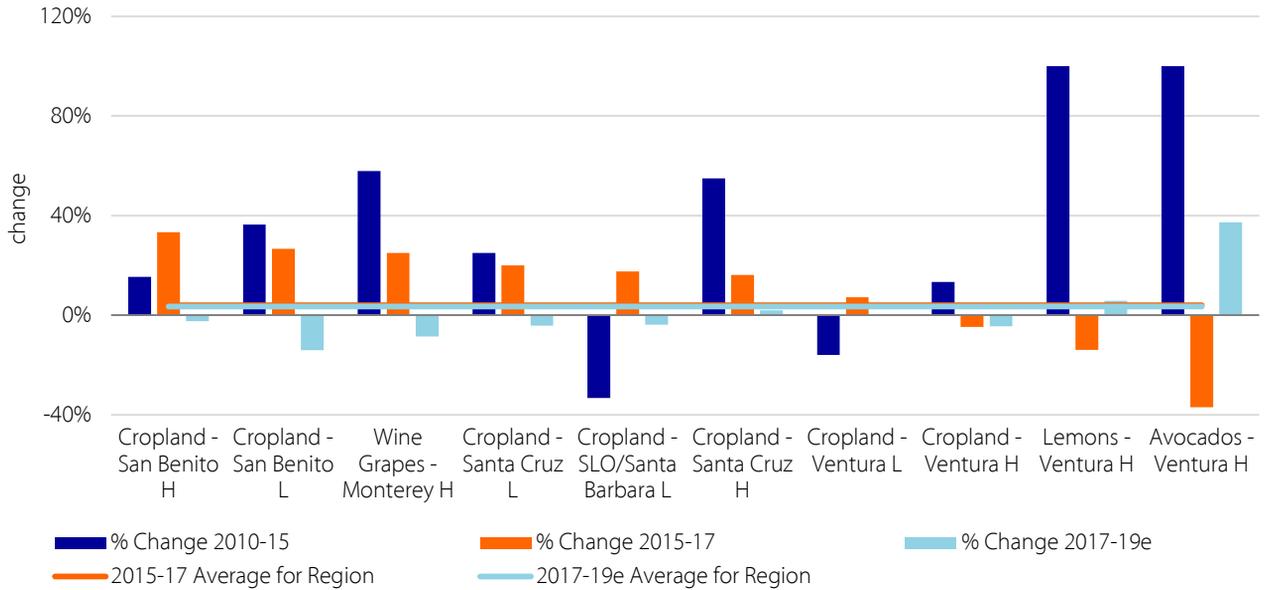
² Estimates represent average expectations (baseline), under currently expected conditions. Actual changes can vary significantly, depending on the specific land sales that occur/do not occur in 2018-19.

SGMA to Have Bigger Impact on Coast Than on Sacramento Valley



Land values in Central Coast areas where drought has persisted have come under pressure in recent years, and future SGMA implementation is likely to begin pressuring other Central Coast areas, due to heavy reliance on groundwater.

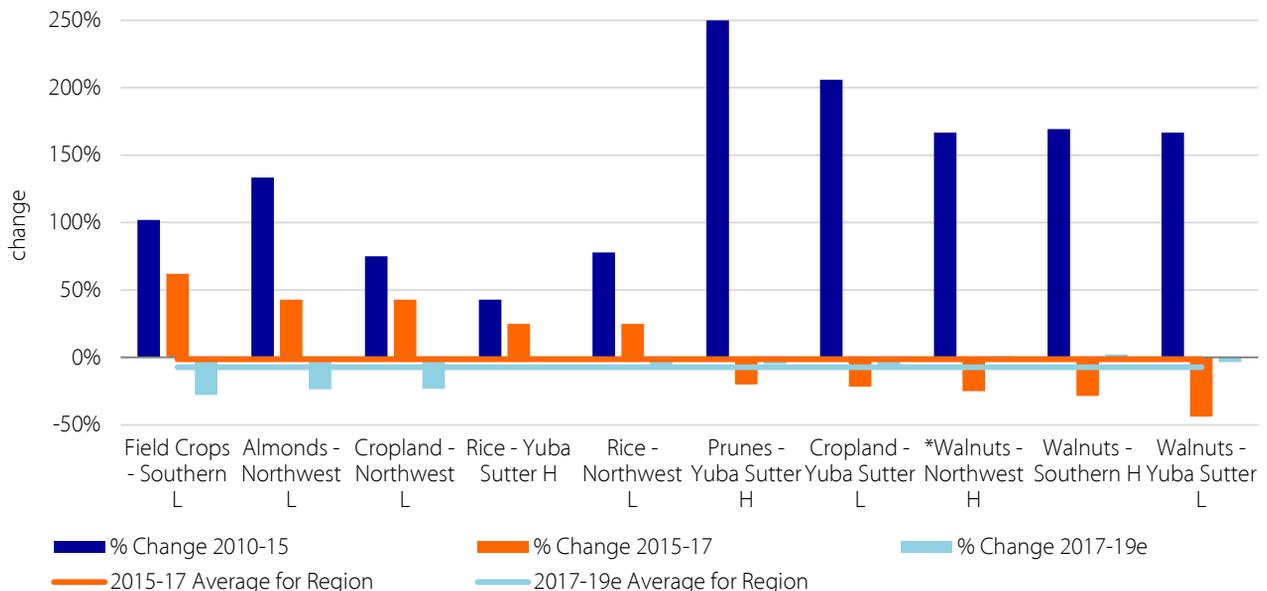
Average Expected Changes in Central Coast Land Valuations Heavily Depend on Specific Location and Land Use



Source: California Chapter ASFMRA, Rabobank 2018

On average, higher relative surface water reliability in the Sacramento Valley has helped to maintain land values, but unsustainable increases have given – and will continue to give – way to declines in specific areas and crops.

Average Walnut Orchard Valuations in the Sacramento Valley Are Expected to Stabilize a Bit*



Source: California Chapter ASFMRA, Rabobank 2018

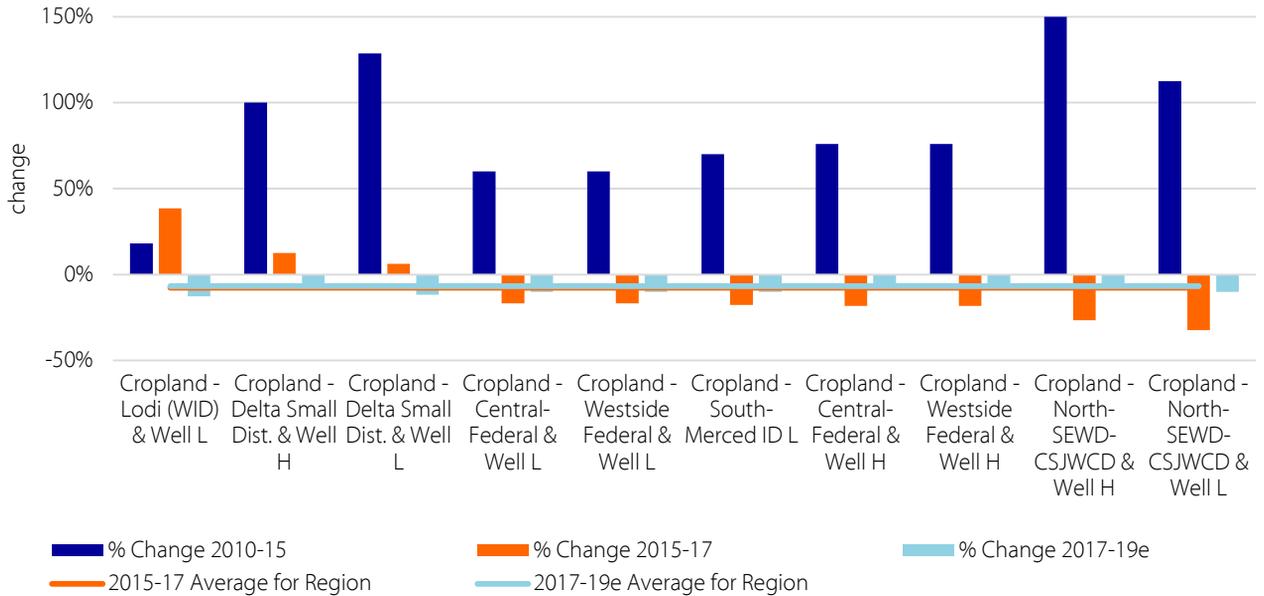
* 2010-14 and 2014-17 changes shown for Northwestern Sacramento Valley walnuts

Even Properties With Robust Surface Water Have Economic Limits



SGMA implementation, combined with the state's plan to commandeer additional river water, has created some buyer uncertainty in the Northern SJV land market. Further value declines of 5% to 10% are expected.

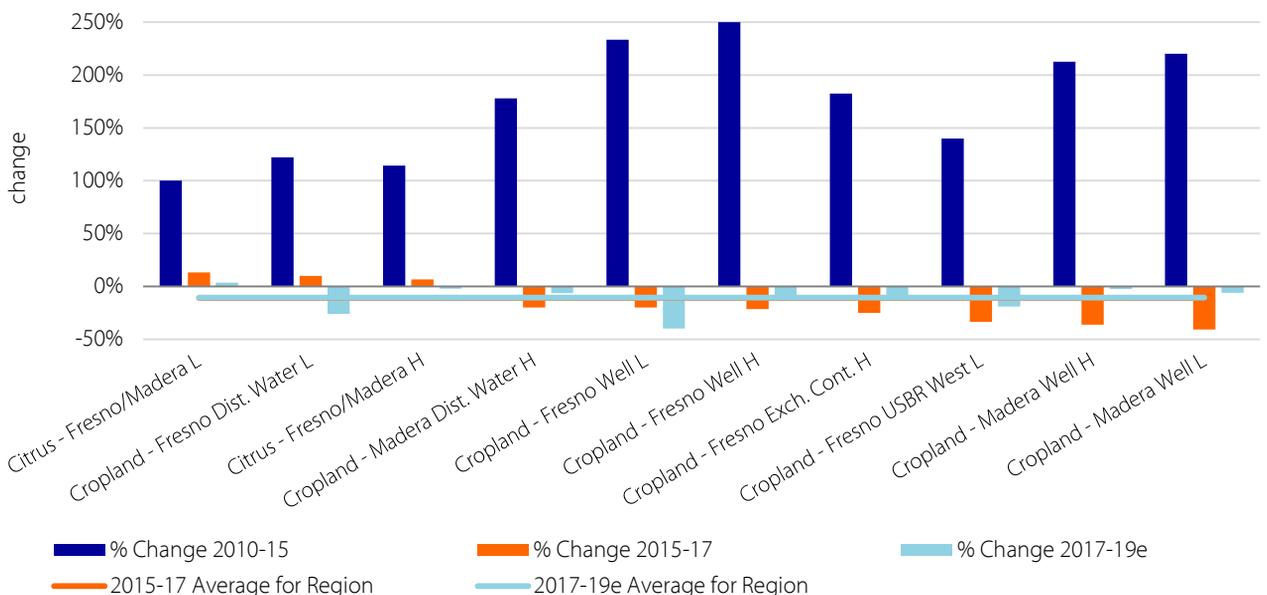
Northern San Joaquin Valley Land Valuations Are Expected to Continue to Decrease at a Slightly Slower Pace³



Source: California Chapter ASFMRA, Rabobank 2018

Central San Joaquin Valley properties with little to zero access to surface water – including well-only and western federal district water – will continue to be hit hardest by SGMA, but some other district properties are likely overvalued.

Central San Joaquin Valley Well-Only Property Values Will Continue to Slide, and District Land Is Not Immune



Source: California Chapter ASFMRA, Rabobank 2018

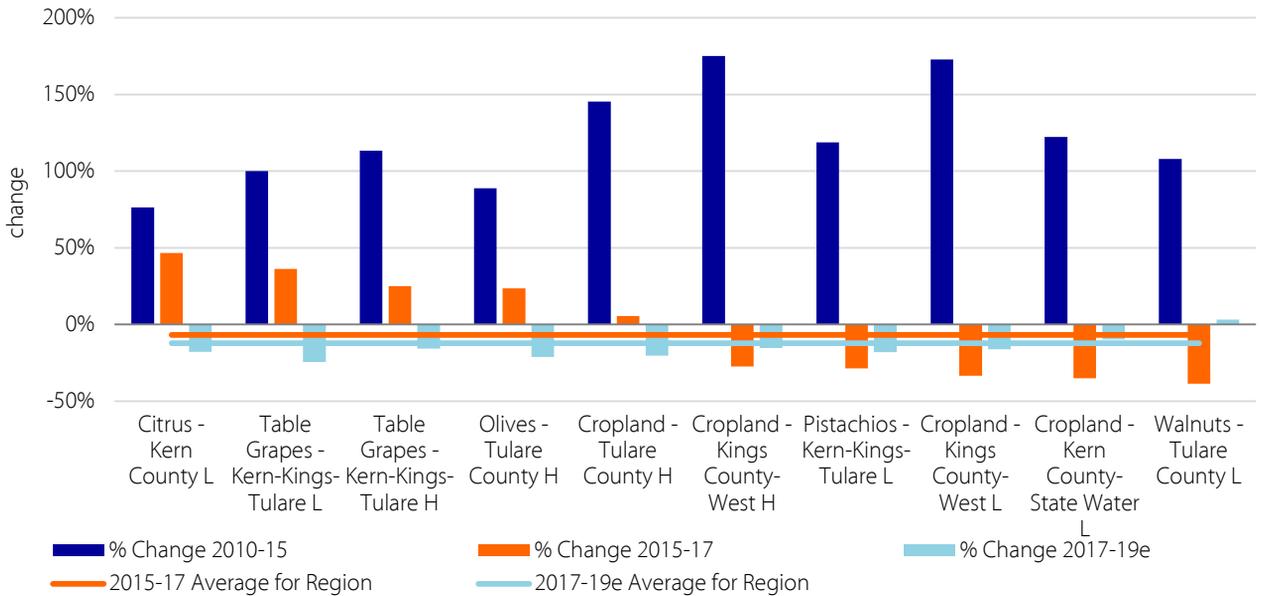
³ WID (Woodbridge Irrigation District), SEWD (Stockton East Water District), and CSJWCD (Central San Joaquin Water Conservation District)

Value Declines in Some Properties Will Accelerate, While Others Hold



A combination of ongoing lower tree nut prices, forthcoming SGMA implementation, and recent run-ups in value are expected to lead to additional downward pricing pressure on most Southern SJV properties.

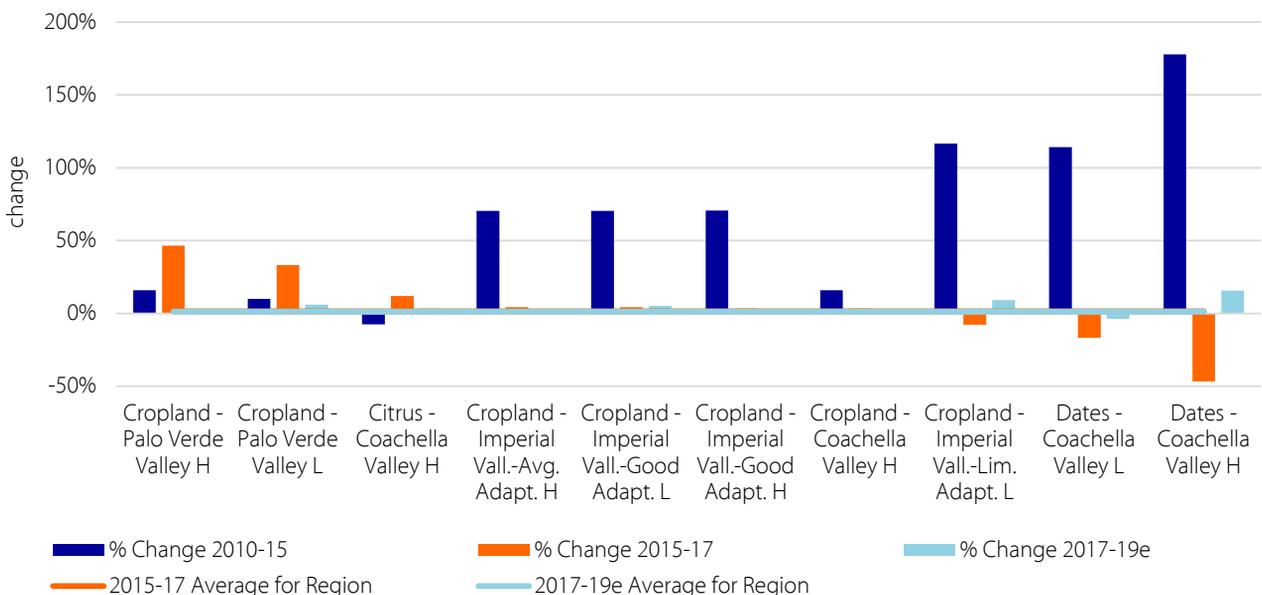
The Decline in Average Southern SJV Land Values Will Accelerate Slightly



Source: California Chapter ASFMRA, Rabobank 2018

Southern California land values have generally been stable to positive, a trend which is expected to continue. Colorado River water access, a favorable marketing window for produce, and a strengthening hay market support valuations.

Colorado River Water Access Keeps Southern California Land Values Relatively Stable



Source: California Chapter ASFMRA, Rabobank 2018