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The Economics of Land Markets: Speculation, Development and Housing Affordability

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Every study prepared and commission report issued on the decline of housing affordability identifies regulation (e.g., low density zoning) and other delays in obtaining development permits as primary culprits. What we see across the country is widespread concern, particularly in suburban and rural communities, over the potential problems of environmental degradation, worsened traffic congestion, increased property taxes for schools and the cost of infrastructure expansion, and loss of open space. Responding to citizen concerns — and sometimes having development proposals rejected because of them – - does add to the cost of housing development. But, what must be understood is that even should such "anti-growth" resistance be substantially reduced, **housing will not become more affordable without other very specific public policy changes. A brief examination of how communities develop reveals why even the potential for changes in regulation will exacerbate rather than help make housing more affordable.**

The earliest suburban communities spread out from the rail lines linking those communities with the urban center. As public infrastructure was extended beyond the cities, farmland became increasingly more developable for residential, commercial or industrial use. Developers and **land speculators** bought out many farmers (who often took their profit in increased land values to purchase much larger farms in more distant locations). The developers obtained approval for large subdivisions of homes, and the speculators waited for the price of land to rise ever higher. Beginning in the 1950s, state and Federal subsidies for highway programs expanded accessibility into areas not served by "mass transit." New communities sprang up seemingly overnight; and, because many speculators continued to hold their sites off the market, development was forced to more and more distant locations — absorbing farmland and open space.

During the 1950s and 1960s, the cost of suburban land for housing, although increasing, was still relatively inexpensive; and, people wanted space between themselves and their neighbors — a luxury few enjoyed as city dwellers. As a result, minimum acre or lot size zoning was adopted to protect the character of suburban communities. Ironically, a secondary reason for this type of zoning was to reduce the potential for overdevelopment. However, as vacant land disappeared (or was being held for speculation), **the price of land** was driven up considerably and developers were forced to ever more distant farming areas to find land on which they could build houses people could afford.

The tendency for land to increase in value does have limits. Widespread unemployment and recession cause land values to fall like a house of cards hit by a stiff wind. Even when economic conditions are favorable, land prices are subject to downward pressures that include the household income of potential homebuyers, the market rate of interest charged by lending institutions for mortgage loans, the costs associated with actual construction of housing units, and the impact of public policies such as zoning and taxation.

When a developer makes an offer to a farmer, speculator or other landowner for a site, zoning and other development costs are important components in determining the maximum price that can be paid while still looking forward to a reasonable profit. If land prices are rising and the present owner is under little financial pressure to sell, the developer may be forced to pay much more than the development plan can absorb. One way to change the financials is to apply for a zoning variance that would permit a more intensive use of the site (i.e., higher density or high-rise development). When such variances are approved, however, all other landowners will thereafter capitalize this potential for higher density development into their asking prices.

Another public policy with direct and normally negative impact on housing affordability is the **property tax.** Most communities do a very poor job of assessing undeveloped land to reflect increases in market value. Housing, on the other hand, is heavily taxed, taking homeownership out of the reach of many families who might afford a basic mortgage payment but cannot afford the extra $100-$300 a month in property taxes. If the annual cost to landowners of holding land equated to its annual increase in value, far less land would be held for speculation and the price of land would stabilize and gradually decline. **With more landowners offering their land for development, the costs associated with site improvement (i.e., bringing in streets, utilities, sewer and water lines, etc.) would be absorbed by landowners in the form of lower prices. Herein lies the key to housing affordability.**