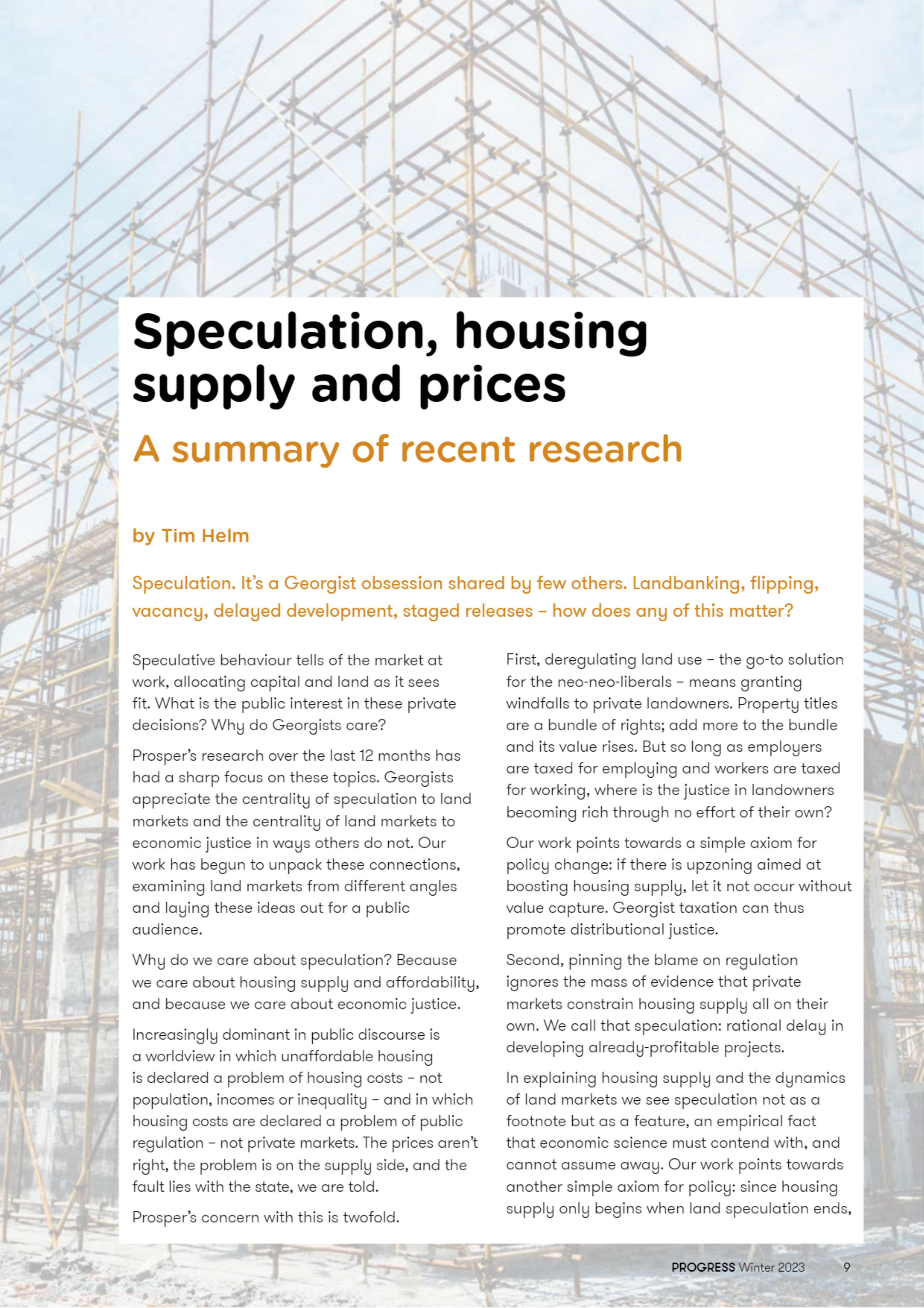


Speculation, housing supply and prices

A summary of recent research

by Tim Helm

Speculation. It's a Georgist obsession shared by few others. Landbanking, flipping, vacancy, delayed development, staged releases – how does any of this matter?

Speculative behaviour tells of the market at work, allocating capital and land as it sees fit. What is the public interest in these private decisions? Why do Georgists care?

Prosper's research over the last 12 months has had a sharp focus on these topics. Georgists appreciate the centrality of speculation to land markets and the centrality of land markets to economic justice in ways others do not. Our work has begun to unpack these connections, examining land markets from different angles and laying these ideas out for a public audience.

Why do we care about speculation? Because we care about housing supply and affordability, and because we care about economic justice.

Increasingly dominant in public discourse is a worldview in which unaffordable housing is declared a problem of housing costs – not population, incomes or inequality – and in which housing costs are declared a problem of public regulation – not private markets. The prices aren't right, the problem is on the supply side, and the fault lies with the state, we are told.

Prosper's concern with this is twofold.

First, deregulating land use – the go-to solution for the neo-neo-liberals – means granting windfalls to private landowners. Property titles are a bundle of rights; add more to the bundle and its value rises. But so long as employers are taxed for employing and workers are taxed for working, where is the justice in landowners becoming rich through no effort of their own?

Our work points towards a simple axiom for policy change: if there is upzoning aimed at boosting housing supply, let it not occur without value capture. Georgist taxation can thus promote distributional justice.

Second, pinning the blame on regulation ignores the mass of evidence that private markets constrain housing supply all on their own. We call that speculation: rational delay in developing already-profitable projects.

In explaining housing supply and the dynamics of land markets we see speculation not as a footnote but as a feature, an empirical fact that economic science must contend with, and cannot assume away. Our work points towards another simple axiom for policy: since housing supply only begins when land speculation ends, use the right taxes to end speculation. Georgist taxation can thus promote economic prosperity.

Those are Prosper's interests in current debates within economics and policy around the contributors to unaffordable housing and the policy means of dealing with them.

Since the last edition of *Progress*, Prosper's staff and research network have explored different aspects of these ideas by way of three major reports, which we summarise here.

Staged releases: Peering behind the land supply curtain

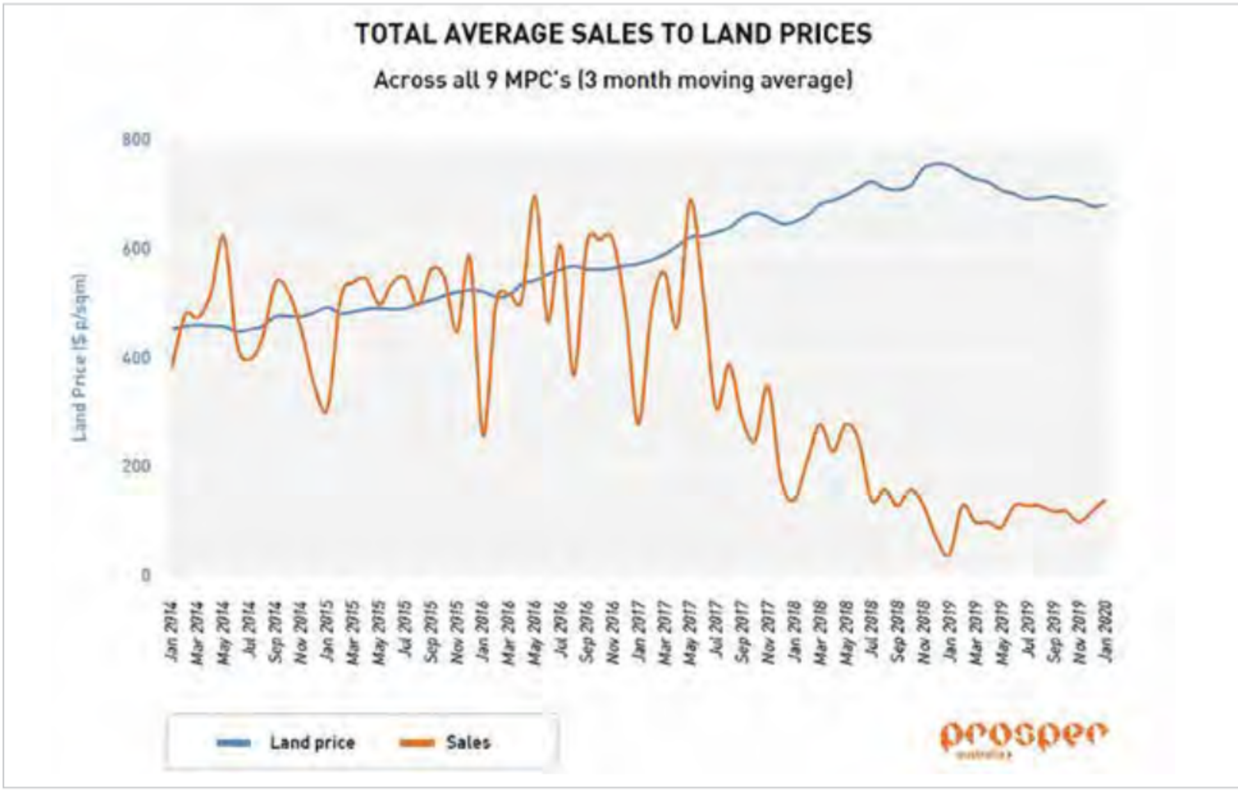
In his final report for Prosper, released in July 2022, Karl Fitzgerald investigated the rate of lot sales in major master-planned housing developments. His report revealed a "staged release" strategy in which sales rates respond positively to price growth but are slowed when necessary to avoid causing supply-led price declines.

Based on records of over 25,000 sales across nine subdivisions, the report examined the speed at which properties were released to the market, the determinants of those sales rates, and the resulting pricing outcomes.

After an average 10 years of production time, the subdivision developers in the study still held an average three-quarters of their land bank vacant, pointing to an expected total development time frame of 40 years on average.

Instead of land prices falling with such massive supply capacities at hand, they grew by a sobering 5.5% per annum in real terms. Sales rates varied significantly according to market conditions, with faster sales when the market was running hot and markedly lower rates as the market cooled. Developers preferred to continue pushing prices higher, letting sales rates drop, than to maintain sales by lowering prices.

During these periods developers also reported concerns of "stock overhang" to investors, indicating that they were able to sell more, but unwilling to reduce prices to do so. Instead, they preferred to wait for market conditions to improve. This pricing and sales response reflects an approach that serves shareholders and financiers, but not the public interest in lower land prices. Land banking of this type holds the promise of supply-led affordability at bay.



How could this occur? What explains this behaviour?

Land prices are not grounded in any kind of cost. Developers selling serviced lots set prices to meet the market, not to recover the costs of labour and capital inputs, as in ordinary industrial production. Why would the developers in Prosper's report keep increasing prices if it meant losing sales or market share? And what does it say about our ability to 'flood(ing) the market' with zoned capacity in order to lower prices that the recipients of these rights refuse to flood the market with land for housing?

It suggests that unlike markets for goods and services, property markets are inherently monopolistic, and cannot be made more competitive. This was always the classical understanding: Smith, Ricardo, Mill and George would have found the idea of "competitive land markets" a bemusing oxymoron. As leading legal scholar Eric Posner puts it, "property is only another name for monopoly". Land is not the output of a production process, but is an asset, and is managed as such. This was borne out in the report data: land banks were patiently drip-fed to market, with development projects timed to maximise overall returns.

> '... property markets are inherently monopolistic, and cannot be made more competitive.'

Planning deregulation, housing supply and affordability: What if land markets are monopolies?

Prosper's December 2022 discussion paper, authored by Jesse Hermans and Emily Sims, looked at the debate around the role of planning deregulation in housing affordability, canvassing the empirical evidence on whether 'upzoning' can spur faster housing supply and the conceptual disagreements about whether this is theoretically plausible.

The common story supporting planning deregulation as a solution to high house and land prices is that prices are high because the supply of new dwellings in accessible, desirable locations has not kept pace with demand, due to onerous regulatory constraints.

That planning constraints are cited uncritically by housing economists as the problem and rezoning championed as the solution has arguably empowered successive federal governments to defer politically unpopular demand-side (tax) reforms, and to side-step their responsibility to invest in non-market housing for our most vulnerable citizens.

The discussion paper argued that the persistence of this story and the popularity of the models that underpin it may have less to do with its intellectual coherence and more to do with the ways in which it serves sectional interests. Only rarely do the champions of this story acknowledge the political economy of private rent capture through unpriced rezoning.

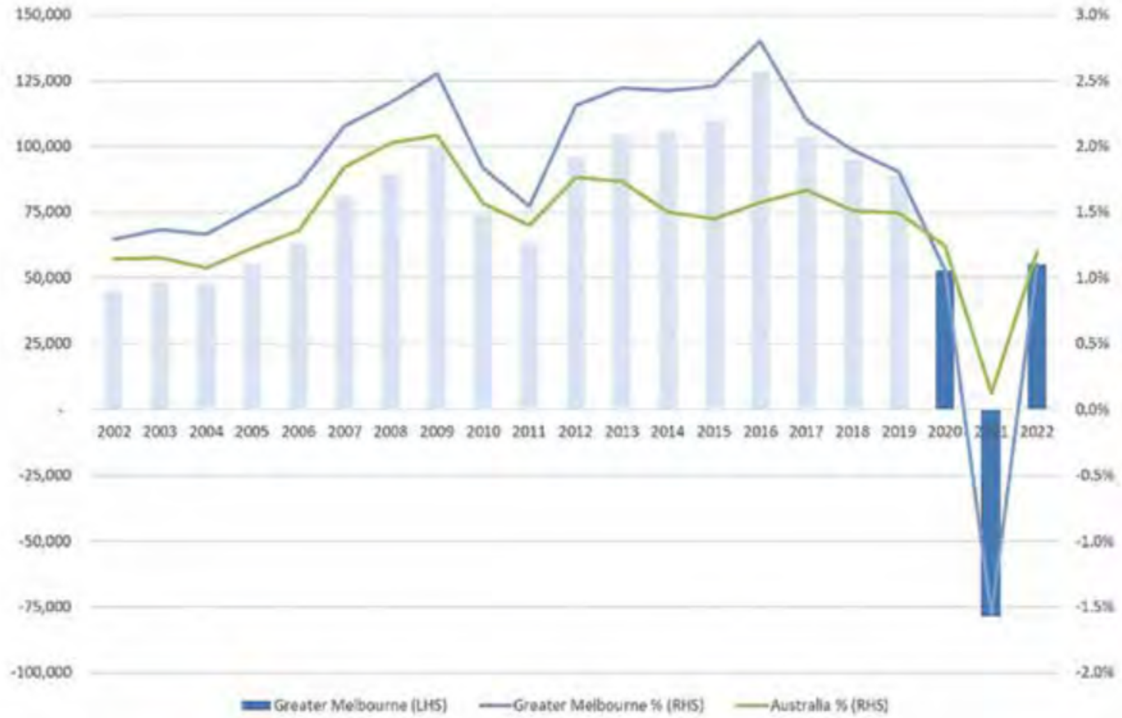
What of the empirical data? Though the merits of urban intensification are undisputed, and upzoning for higher intensity uses is a necessary precursor to infill development, it is not clear that providing additional development rights and opportunities necessarily results in additional dwelling construction, or whether it merely reshuffles the location of dwellings. The discussion paper found that the empirical evidence for the centrality of planning deregulation to deliver additional development and increased affordability is weak.

It also posed an idea intended to clarify arguments and resolve theoretical disagreements: that the ultimate source of contention in these debates arises from different conceptual models of land rent held, without explicit recognition, by the participants.

Specifically, one worldview sees land rights as akin to a 'quota', a model which suggests that increasing the supply of development permissions should devalue them as it does for other regulated permissions (e.g. taxi medallions), and should expand opportunities for development and reduce the price of land.

Melbourne's population shrank, for the first time since the Great Depression

Population growth 2002 to 2022, Melbourne and Australia, year to June



Source: ABS Regional population 2021–22

A 'monopoly' model of land, on the other hand, suggests that land values are determined by the highest and best use of each unique site, with those values not diminished by the potential uses of neighbouring sites. Expanding development permissions, in this model, expands the value of their monopoly to each monopolist.

As the discussion paper explains, various other conceptual frameworks, such as the distinction between cities that are 'open' and 'closed' to migration in the Alonso-Muth-Mills model of urban form, or the emphasis on 'scarcity effects' in which shortages of development rights are presumed to materially affect housing supply, can be linked back to the analyst's assumptions about the nature of land as either innate monopoly or socially-regulated property right in artificially short supply.

Melbourne's pandemic rental dynamics: an (un)natural experiment in excess supply

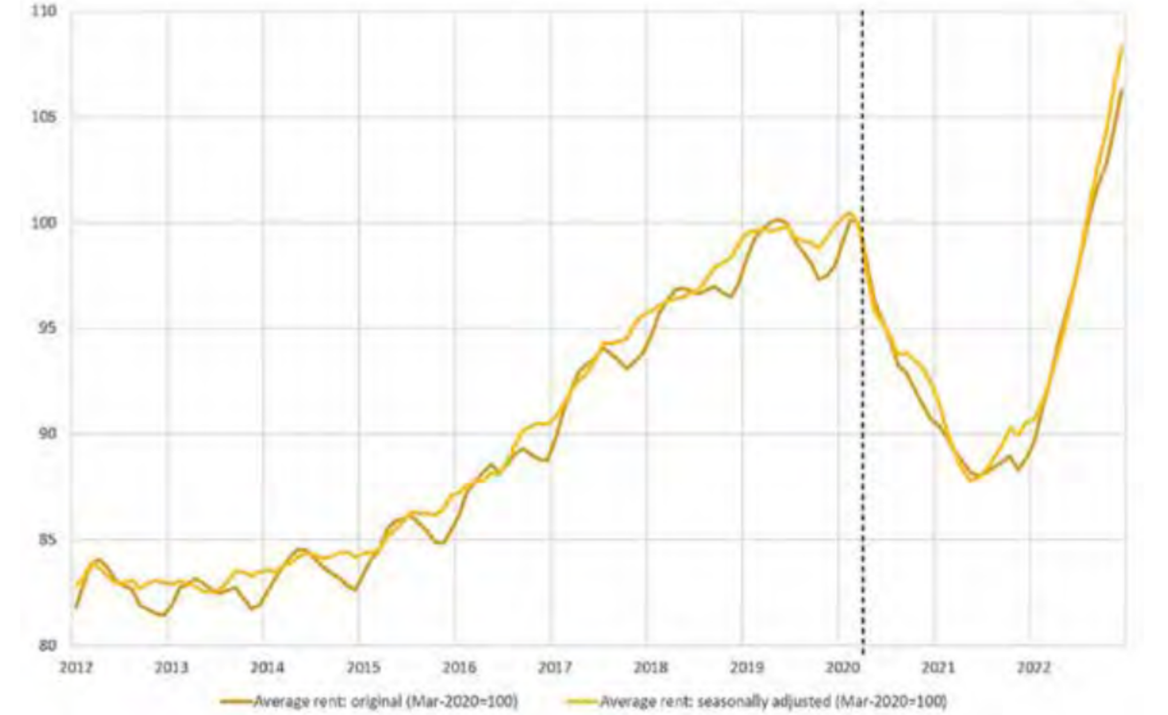
Prosper's May 2023 report, authored by Tim Helm, took Melbourne's experience of declining population throughout the pandemic years as the basis for an exploration of the impacts of housing supply on rents and the nature of adaptive responses to price changes.

As a result of closed borders and extensive lockdowns, Melbourne experienced a population shock over 2020 and 2021 far larger than for other Australian cities, losing around 80,000 residents or 1.6% of the population in the year to mid-2021 – the first year of negative growth since the Great Depression. Construction, meanwhile, continued more or less unabated.

The report argued that the scale of this imbalance between construction and population growth made pandemic-era Melbourne a remarkable natural experiment in the consequences of excess housing supply,

Average rents fell -12% by mid-2021, regaining this by mid-2022

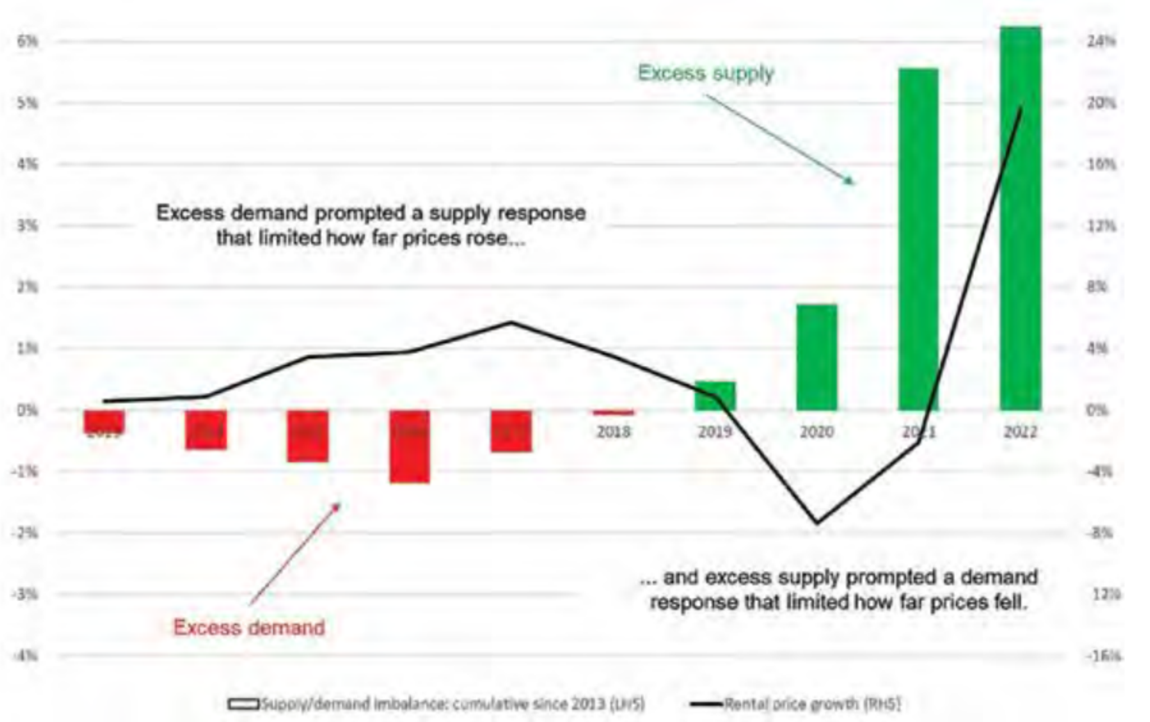
Melbourne average rent to December 2022, indexed to March 2020 = 100



Source: SQM

Excess supply did far less to lower prices than excess demand did to increase them

Excess supply (dwelling growth less population growth) cumulative from 2013; YoY rent growth



Source: Vic Department of Transport and Planning Housing Development Data; ABS estimated dwelling stock June 2022; ABS Regional Population 2021-22; SQM one in principle capable of shedding light on the question of whether new housing can ever be supplied fast enough to out-run adaptive consumption and migration responses so as to meaningfully lower housing costs.

Over the two years to mid-2021 construction in excess of population growth generated an excess supply of dwellings of 5.1% to 6.7% of the housing stock – equivalent to adding 100,000 to 130,000 dwellings more than were required to house the population at the pre-pandemic average household size.

The speed and scale of this shock far outstripped what even the most optimistic advocate for supply-side regulatory reform would claim is possible – suggesting Melbourne's experience should be a living demonstration of the value of land use deregulation.

Yet the report found the effects on housing costs were small and short-lived. Average market rents fell by only 12% to the bottom of the market in mid-2021, and had recovered to pre-COVID levels by mid-2022.

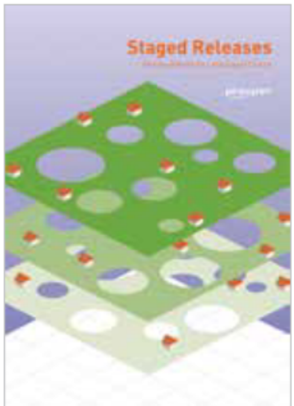
Some 35,000 dwellings more than usual sat vacant or under-used over the entire calendar year of 2021 – a 51% increase that absorbed one-third of the excess supply shock. The remainder was absorbed by way of greater per-capita housing consumption, resulting from a combination of changing preferences and demand responses to lower prices.

Thus the consequences of this 'virtual building boom' for housing affordability were minor: the report suggested the average Melbourne tenant saved around $2,200 for just one year, while by contrast a mortgaged new buyer of the median Melbourne home faced $30,000 more per year in interest expenses as a result of the cash rate rising over the 12 months to May 2023.

The report's findings sound a cautionary note for policymakers placing market supply at the centre of housing policy, with Melbourne's experience suggesting the most effective means of promoting more affordable housing for those in stress is not on the supply side, but on the income side. This was demonstrated during the pandemic itself: over the same period considered in the report, the temporary coronavirus supplement delivered eligible welfare recipients almost $9,000 each – four times what a flood of excess housing supply managed to briefly deliver in lower rents. •

Scan the QR codes to download these two publications:

Staged Releases report
Pandemic Rental Dynamics report



https://www.prosper.org.au/wp-content/uploads/2023/05/Prosper_Pandemic-Rental-Dynamics_MAY2023_web.pdf

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