Englobo 2014 – landbank profits during an alleged housing supply crisis *by David Collyer*

Land in Australia should be dirt cheap. All levels of government must explicitly recognise outstanding access to land for all is a key national advantage that simply cannot be imitated by other countries. For state governments, close scrutiny of planning and a review of exemptions from State Land Tax are fundamental to reducing land costs.

Listed property developers report their land holdings to the Australian Stock Exchange, which opens a window into the murky world of 'englobo' landbanking. Their 2014 annual accounts show they have 272,000 lots in development, with a disclosed end value of $81 billion.

Sharemarket-listed developers are a minority of developers. Their lot sales are around 25.7 per cent of the approximately 65,000 national residential land sales in the same period identified by the Housing Industry Association1.

Land banking – an especially damaging form of rent-seeking – is more prevalent where land supply is constrained and planning approval processes slow and uncertain. Land banking is also only profitable where the market price of land is rising faster than the cost of capital.

1 http://tinyurl.com/m2rb7ps

In Australia, land cost increases have four drivers:

- restrictive planning,
- the easy availability of credit,
- the speculative appetite of buyers, and
- taxes, notably who pays and where it is taken.

Government has an evergreen task ensuring developers cannot corner the market by confirming and reconfirming land supply is contestable – i.e. there is always the opportunity for someone further afield to compete on price and undercut. Planning constraints, like urban growth boundaries, reduce contestability and the ability of competition (or the threat of competition) to hold down prices. They effectively allow oligopolistic returns by conferring market power upon landowners.

Withholding vacant land from use displaces activity and drives up land costs – to the great advantage of all who own developable land. Central to affordable, available land is whether land owners on the fringe are allocating land to best use according to price signals; or speculating in an asset class rather like gold bullion - holding rather than selling land into use.

Land is finite. No more of it can be made. However, growing cities nip at the low-value agricultural land on their periphery and developers transform these broadacres into house parcels, building roads and installing utility connections.

But there is a dilemma: agricultural land advantaged by rezoning is immediately revalued by the market to final lot value less engineering construction cost and an allowance for interest costs on holding. Developers must straddle this intersection or become price-takers - like the homebuyers they plan to sell to.

Urbis2 examined the benefits in a study of properties of between five and 15 hectares around Wyndham, Victoria and found the following uplift in the price of land when re-zoned to residential from rural:

Land outside but near urban growth boundary $50 000 – $100 000 per hectare

Rezoned urban growth zone away from existing development $250 000 – $400 000

Rezoned urban growth zone next to existing development $60 000 hectare

Landbank Duration

As a multiple of the past year's sales, listed developers hold approximately 14.9 years supply. This is a significant reduction from 2013, where developer landbanks averaged 19.3 years.

2 http://www.thefifthestate.com.au/articles/how-much-does-rezoning-add-to-land-value/30279

The recent convergence of landbanks around the average 14.9 year sweet spot suggests this is where maximum landbanker returns are currently found.

Lend Lease significantly reduced its landbank from 33.3 years in June 2012 and 28.2 years in 2013 to 19.1 years supply by steadily increasing development and adding to its raw holdings with restraint. The company will no doubt argue other factors are at play, yet it is beyond question holding land against such very distant objectives is an investment without skill and a poor use of shareholders funds.

Queensland developer Sunland has significantly increased its years of supply by increasing landholdings – from 4.3 years in 2012 to 12.5 years in FY 2014

At the short end of the range, home builder AV Jennings holds 7.3 years supply, mostly for its own use.

Listed Developer landholdings

	Lots settled	Lots in development	Disclosed end value	Average lot value	Land bank	Debt/ debt+equity[1]
	2014	Number	$ millions	$'000	Years	
Australand[2]	1 287	19 450	7,500	259	15.1	34.6%
Sunland	446	5 556	3,200	174	12.5	19.4%
AV Jennings	1 254	9 214			7.3	20.3%
PEET	3 491	48 187	11 300	234	13.8	41.6 %
Cedar Wood Properties		>10 151				28.9%
Mirvac	2 482	30 538			12.3	45.8%
Lend Lease	3 425	67 560	37,700	558	19.1	32.5%
Stockland	5 219	81 510	20 400	250	15.6	28.5%
Totals	**17 604**	**2 72 166**	**81 100**	**NC**	**14.9[3]**	

Source: ASX Company reports

Developer Debt

Previous land price downturns have been characterized by developer bankruptcies as banks called loans to this traditionally highly-geared and strikingly illiquid industry. Economic history shows these downturns destroy land developers who misjudge economic trends and carry high levels of debt into land price corrections.

Australia's listed developers have significantly and painfully reduced their debt since 2007 via capital raisings and asset sales. What little they do have is likely secured on their income-producing commercial and industrial properties. Organisationally, they could easily survive a major land price correction, though shareholders equity will shrivel mightily.

Developer sought returns

Residential development at Stockland is around 20 per cent of its activities, yet the division made an EBIT profit margin of 23.4 per cent and a return on assets (ROA) of 12.2 per cent on core portfolio development. Stockland puts their workouts on impaired assets aside, and energetically points to a FY14 ROA on core projects of 18.4 per cent.

One wonders why it bothers with commercial (ROA 8.4 per cent) and retail property or retirement villages (ROA 4.5 per cent) when residential development can provide such stellar returns. Investor activists take note.

Planning

Planners err in thinking their rationing of urban land is a 'flow control valve' whereby the pressure on price can be carefully controlled. The reality is that they have an on/off switch for a nuclear chain reaction. This is why there are no urban economies that are just "slightly unaffordable"; data sets of median multiples (median house prices over median wages) tend to cluster around 3, and then around 6, with a tail going up to 12.

The removal or modification of regulatory constraints on the supply of land, along with more permissive planning policies and infrastructure provision, would increase competition amongst both developers and land owners, and limit their ability to ration sales and sustain high prices. Higher levels of competition would also deter land banking by increasing holding risk, as another nearby owner would always have the opportunity to offer into the market ahead of the land bankers.

While developers can rightly argue they are constrained by government planning controls, in practice, this is a feature not a bug. It provides an extremely high barrier to entry, confining development activity to those with deep, patient capital and the expertise to negotiate effectively with government - over years in some cases.

Land under restrictive planning conditions switches from being regarded as a resource to be allocated to best use by the market, to a speculative commodity where motivations become inverted; because once the prices have started rising, the incentive is to withhold it while prices rise some more.

In unconstrained markets, developers tend to just watch out for farms coming up for sale as farms, somewhere within a brief drive of the existing urban area. The turnover of farms tends to be high enough for developers to avoid door-knocking and begging land owners to sell. Instead, developers are forced by urban planning into a gladiatorial contest to outbid each other for uncommitted, zoned land.

Shrinking Lot Sizes

One of the few matters solely in the control of developers is the rate of release, drip-feeding sections at their preferred prices. Not content with this, developers have added a new wheeze: reducing lot sizes.

The argument floated around is that somehow all home buyers have abandoned the dream of a villa on a garden and now want a townhouse on 350 m2 – never mind it will be on the outskirts. In Melbourne or Sydney this could be 60 km from the CBD.

Smaller lot sizes are mainly achieved by reducing the depth of lots. Yes, the developer gets more lots per hectare, but must install more roads and utilities to achieve this. The loss of the prized Australian backyard and private open space will have major future social consequences.

Land and Buildings

Australia's residential property price bubble is a land-only bubble. Construction costs have not budged for thirty years, as the chart below makes abundantly clear.

Australians already enjoy spacious and comfortable housing. Imagine if we could back this with inexpensive land – as it was until the mid-1990's

State Land Tax

In one of the most anti-citizen regulatory changes I have ever observed, in June 2014 former Planning Minister Matthew Guy issued a blanket exemption from State Land Tax for all land within Melbourne's Urban Growth Boundary3, even 'shovel ready' land in competed Precinct Structure Zones.

The cost of freshly subdivided land on the outskirts of cities affects the market all the way to the centre. SLT is a small but insistent charge prompting owners to put land into use. Minister Guy removed

3 http://www.prosper.org.au/2014/06/18/no-land-for-you-melbourne/

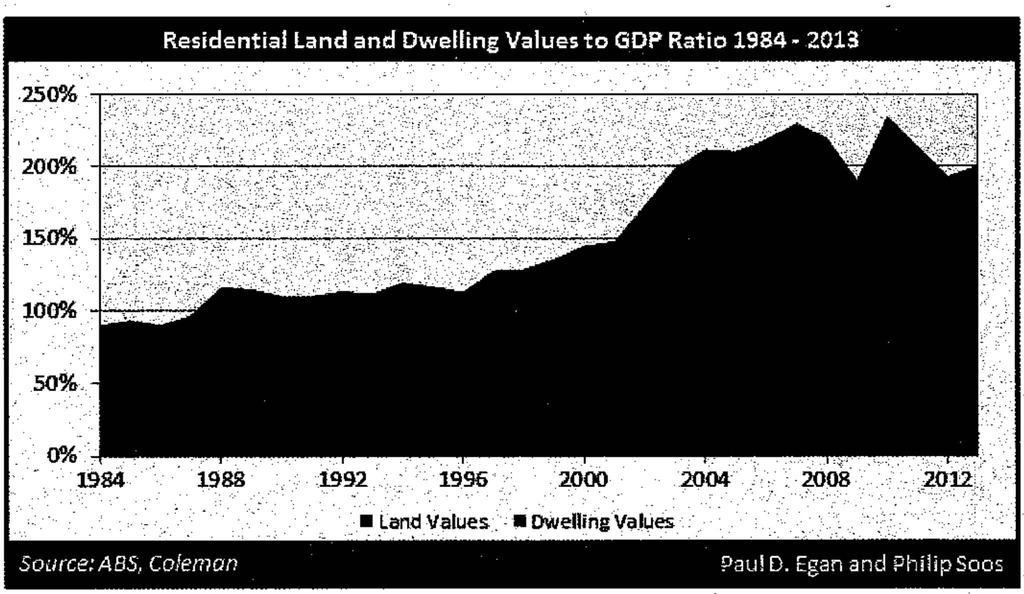
one of the few levers government has available to oblige developers to act.

Thus, The Great Australian Land Bubble goes on…

Listed Developer Land Holdings June 2013

	Lots settled	Lots in development	Disclosed end value	Average lot value	Land bank	Debt/debt+equity[1]
	2013	Number	$ millions	$'000	Years	
Australand	1 788	18 900	7,600	402	10.5	43.0%
Sunland	662	5 322	3,000	563	12.4	3.3%
AV Jennings		9 952				23.4%
PEET	2 091	51 173	10,500	205	25.5	47.6 %
Mirvac	1 809	30 942			17.1	27.1%
FKP[2]	242	4 250			17.6	38.3%
Lend Lease	2 468	69 631	37,400	NC[3]	28.2	31.3%
Stockland	4 641	84 400	21,200	251	18.1	27.6%
Totals	13 701	264 618[4]	79,700	NC	19.3	

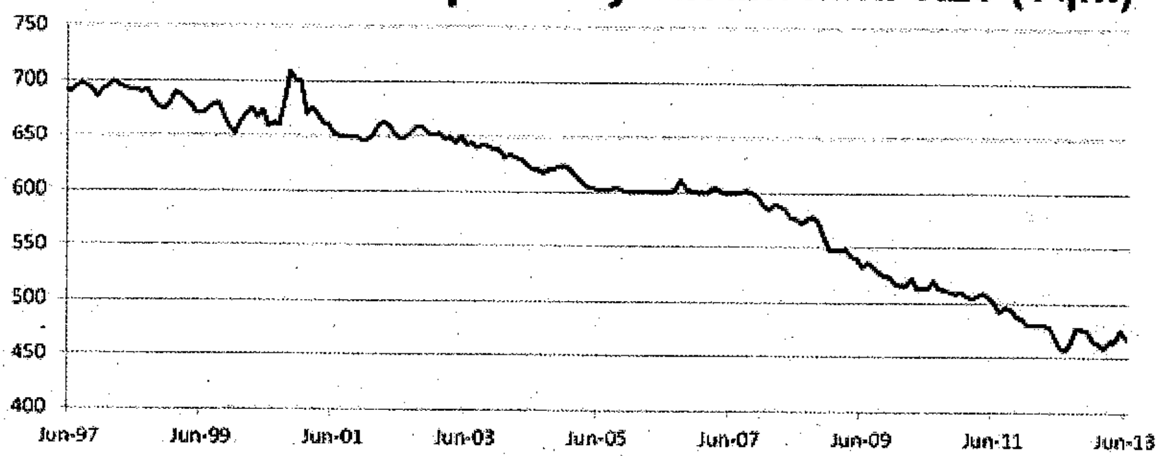
Source: ASX Company reports



Listed Developer Land Holdings June 2012

	Lots settled	Lots in development	Disclosed end value	Average lot value	Landbank	Debt/debt+equity
	Year to 6/13	Number	$ Billions	'000	Years	
Australand	1 108	21 300	8.0	531	19.2	40.0%
Sunland	672	2 889	1.1	380	4.3	9.0%
PEET	2 052	34 000	6.2	182	16.3	56.7%
Mirvac	1 807	29 787	10.6	356	16.5	25.9%
FKP	410	4 725	1.4	287	11.3	NC
Lend Lease	2 059	68 006	13.0	191	33.0	30.6%
Stockland	5 388	87 900	23.0	338	16.3	30.8%
Totals	13 496	248 607	63.3		Av18.4	

Median combined capital city vacant land size (sqm)



Source: RP Data

Source: ASX Company reports

1 Debt calculations include derivatives liabilities
2 The takeover of Australand by Singapore-listed Fraser Centrepoint closed 5 September, with FCL owning 98.31% and expected to exercise compulsory acquisition rights.
3 Landbank by years calculation excludes CWP.