Spatial Economics Research Centre

Friday, 21 June 2013

Ending Land 'Hoarding' won't solve the Housing Crisis

It's reported that Ed Milliband is to call for penalties for developers that 'hoard land'. I do hope not, for reasons discussed in a post from last Septembe

"I find myself increasingly irritated by people pointing to the number of sites with permissions (enough for 400,000 homes we are told) as if this someh proves that the planning system is not part of the longer term problem. First, many of these sites will be in areas that always had low demand. Remember, the UK planning system is incredibly unresponsive to price signals. So no surprise that these sites aren't being developed now demand ha tanked. Second, when those sites are in relatively high demand areas, developers still have strong incentives to hold on to sites, because they know th the long term trajectory of house (and hence land) prices in those areas is upwards. In other words, holding sites becomes more sensible as the gap between current price and future expected price increases. And why do developers expect prices to increase more in the long run? Partly because demand will recover, but partly because the planning system continues to restrict the supply of land in places where demand is highest."

Sure, developers share some of the 'blame' for problems in the housing market. Some of the problem is down to bad practises, bad management etc; some of it down to the planning system itself. But genuine land 'hoarding' (getting planning permission for sites you have no intention of developing in t short to medium run) is only a small part of the problem. Ed Milliband will get headlines for attacking it, but that doesn't bring us any closer to understanding how Labour would try to fix the much bigger problems of housing supply and hence help solve the housing crisis.

Posted by Prof Henry G. Overman on Friday, June 21, 2013 G+1 Recommend this on Google

6 comments:

Mick Beaman said...

I don't agree with your logic. A typical developer might aim at an annual rate of return on capital of 15%. For land prices to increase at this rate they have to doubt every five years. That is some bet and I, as a shareholder, would be livid if they tried it.
The real reason that they hold land is simply because it is an essential component in their business and they need a ready supply. To run out would be catastrophic. 'Just in time' component supply might work for Toyota, but housebuilders rely on a sticky land market and the UK planning system. A much dodgier proposition!

22 June 2013 at 15:17

Prof Henry G. Overman said...

Mick,

I agree with you. But I do think option values explain why land hoarding might be somewhat pro cyclical. This is what is was getting at above - although because the quote taken out of its original context, I can see that wasn't entirely clear.

24 June 2013 at 10:00

Sevrin said...

Hi Mick,

I am not surprised that developers aim for a higher rate of return than the return on holding land because otherwise they wouldn't need to bother developing at all.

The point I am making is one of opportunity cost. They are able to aim for a 15% return because the return on simply holding land is already quite high.

If the return on holding land was not so high (e.g. if holding land was penalised) then they would be forced to accept a much lower return on capital and thus make more developments.

But this doesn't get round the issue of whether planners give enough permissions in the long run.

24 June 2013 at 16:12

Michael Beaman said...

What do you think is the chain of cause and effect there? When margins shrink in a recession developers don't accept a lower return, they usually require a higher target ROCE and accept the cut in volumes. Or am I misunderstanding your point?

24 June 2013 at 22:13

Sevrin said...

The point I am trying to make is that developers have two choices over land they own: develop or hold. Development requires an extra investment. So they choose to develop only when the estimated return on this investment is greater than the long-run land value growth by an amount that is large enough to account for the risk of the investment.

So essentially they develop land where the return on development exceeds the long run land growth plus a risk premium.

In recessions, holding land still has the same long run growth rate but development becomes much riskier and requires a greater risk premium.

But in either environment (boom or bust) bringing down the return on simply holding land should increase investments.

Does this make sense?

25 June 2013 at 14:04

Mick Beaman said...

I tried to respond to this 'on the hoof' using my mobile but suspect that the browser wasn't up to the job. I think that formula doesn't adequately mirror the choices that developers make in practice and over simplifies them. In particular I have never known a housebuilder take the growth in land value into account in the manner you describe. The main aim in a recession is often to sell land to generate cash.

7 July 2013 at 22:05

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