LAND COSTS ARE CREATED NOT GIVEN AND FUELLED BY BUYER ANXIETY

National Science Challenges | BUILDING BETTER HOMES, TOWNS AND CITIES | Ko Ngā wā Kainga hei whakamāhorahora

Dr Kay Saville-Smith & Professor Laurence Murphy

CRESA Centre for Research, Evaluation and Social Assessment

The University of Auckland, New Zealand

It has become taken for granted that the cost of housing is driven by land prices. Land price is generally the biggest ticket item in the cost structure of a new build. But land costs are not a given, they are continually created. Developers set land prices in response to prevailing house prices and many home owners have a vested interest in rising house prices.

Developers actively set land prices

It is commonly assumed that developers are involved in a cost-plus industry and that they passively take land prices as part of their costs. But developers, financiers and valuers actively create the land market through residual valuation. Residual valuation determines what developers and builders are prepared to pay for land.

It is a simple formula with the gross development value based on prevailing house prices in the market and estimates of how much these prices are likely to rise or fall.

Developers have a price point in relation to existing products.

The use of residual valuation has several significant implications:

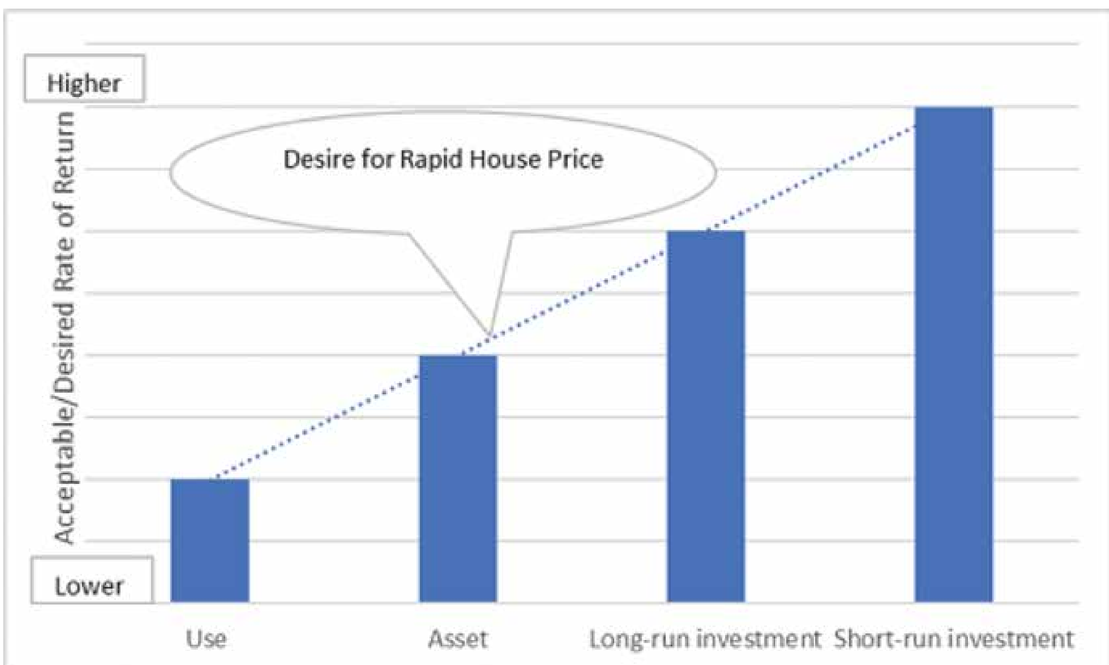
- Lower costs associated with a particular gross development value (GDV) may lead to higher land bids.
- Feedback loops through established valuation practices and legislative requirements mean prevailing bidding becomes part of the land market even when bids are potentially overestimated.
- Undesirable outcomes are associated with overcooked house price estimates. These can prompt a bidder to pay too much and result in land banking because of a lack of working capital or liquidation.
- Housing providers serving households needing affordable housing may struggle to access finance because the financial value of a completed development must be low. Their house prices are calibrated to the affordability of targeted households, not prevailing or future house prices.

Households as home buyers

If developers believe householders are willing and able to pay more for houses, that will be reflected in increased residual valuations.

To understand land costs, then, we have to understand why people want to buy houses. Why are those that can access mortgage finance willing to take on significant debt? Have the motivations for house buying changed? How are house-buying motivations connected to a desire, or at least acceptance of, rising house prices?[1]

Overseas research suggests that home ownership has become increasingly financialised – home ownership has moved from use-value, to a protective asset, to a long-run or even speculative short run investment. This reflects, in part, property- or asset based welfare as a way of retracting the role and fiscal obligations of governments combined with financial interests.[2]



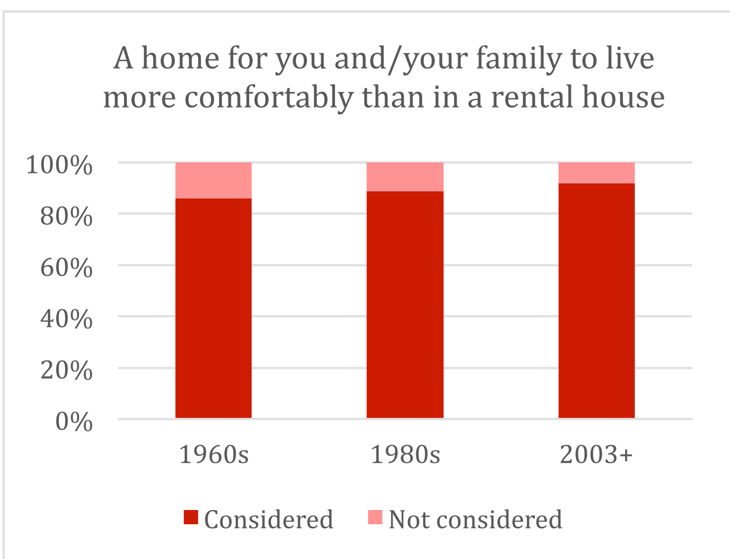
Arguably those who see home ownership as giving them use-value expect lower rates of return than those who see home ownership as a financial investment. Those households may be prepared to pay more for a house with the hope that rapid house price rise will contribute to capital gains with a higher rate of return.

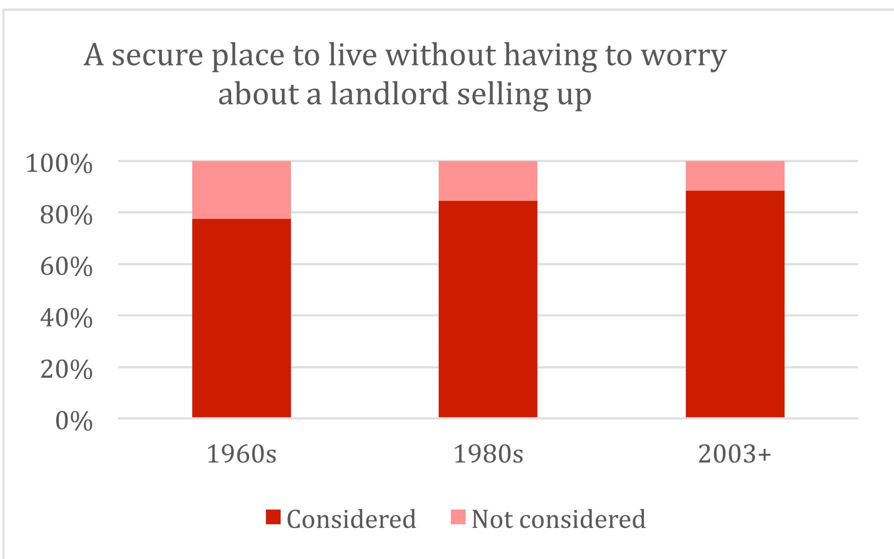
In a national stratified random survey, we asked 946 householders about buying their first home:

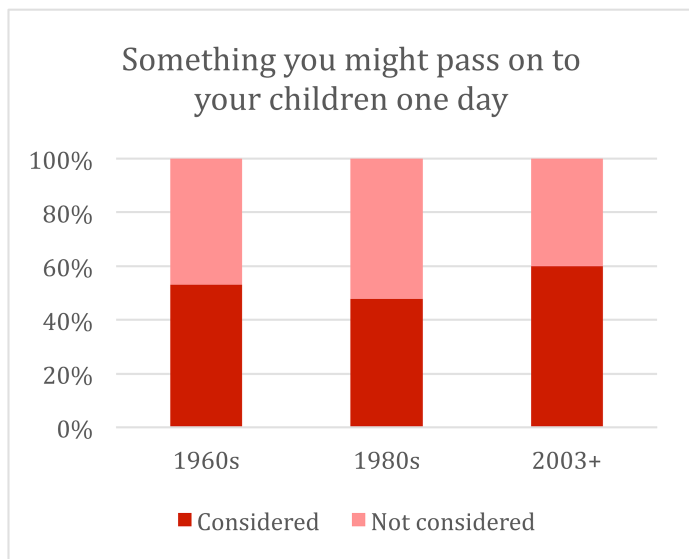
- 139 householders bought their first home in 2003 or later.
- 407 householders bought their first home in the 1980s.
- 400 householders bought their first home in the 1960s.

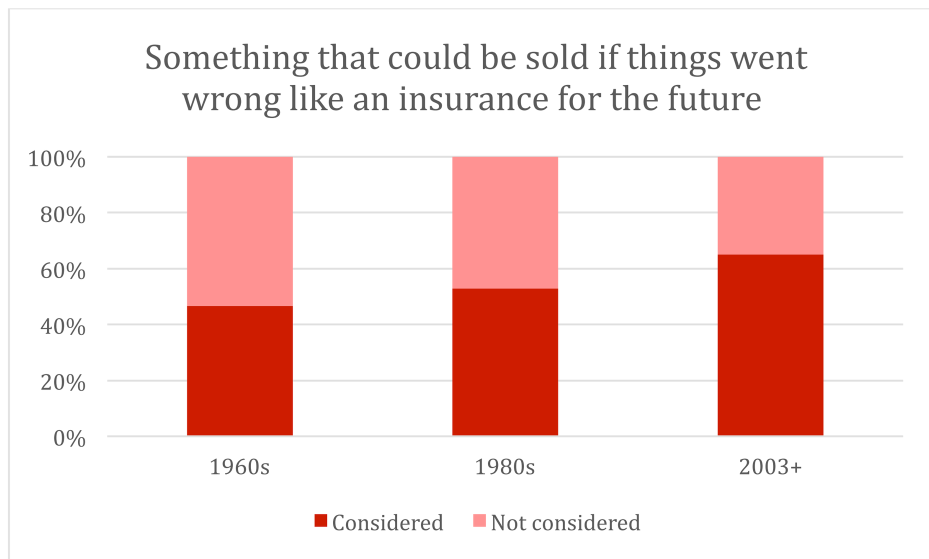
Householders were asked to respond to a series of different functions that their home purchase could have involved. The key findings are:

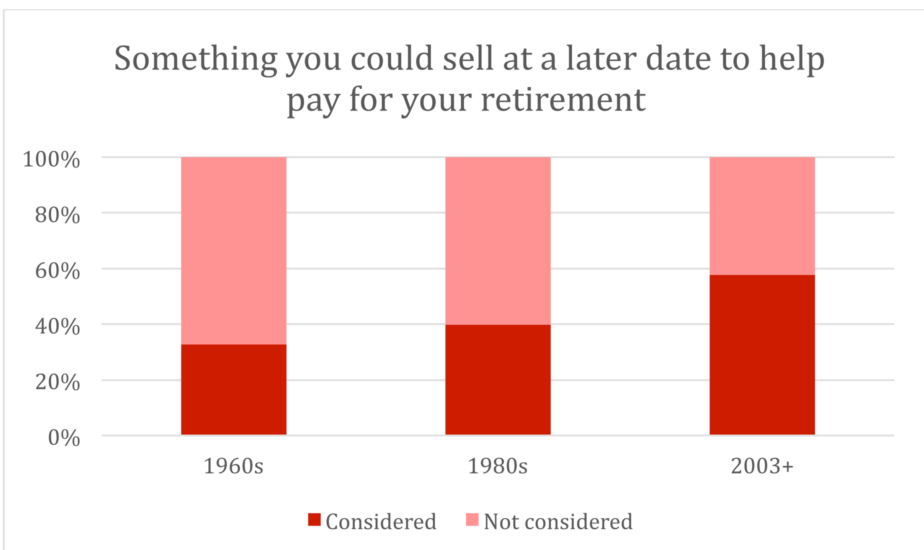
- Home ownership is universally seen as having a use value. Irrespective of the period in which first home buying occurred, buying a home is seen as providing security and comfort unavailable in the rental market.
- Home ownership is seen as providing an intergenerational asset, again irrespective of the period in which first home buying occurred.
- Later generations of first home buyers are more likely to see home purchase as a protective asset acting as a virtual insurance system and as source of retirement income. This implies anxieties around superannuation and the availability of support through ‘hard times’.
- Home buying as speculative investment or involving a desired rate of return is not common, but it is strongly associated with later generations of home buyers who bought their first home in 2003 or later.

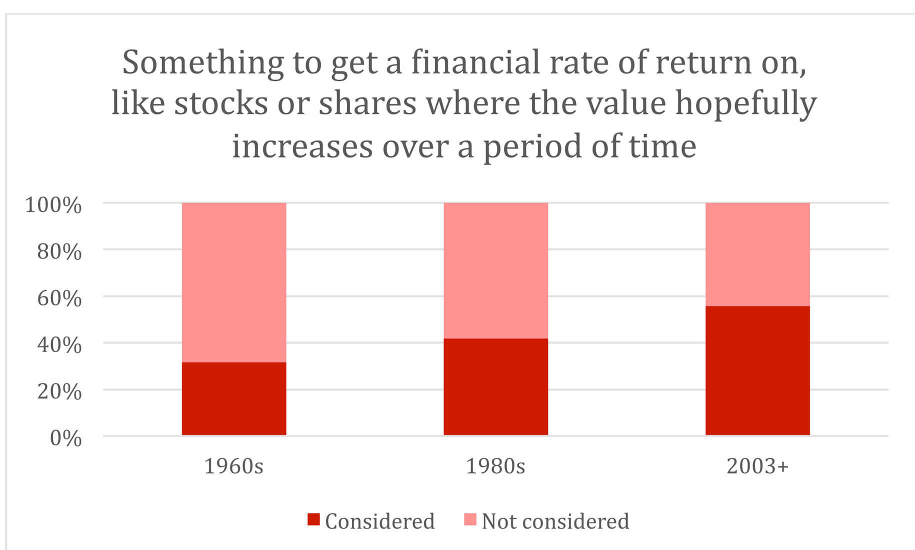


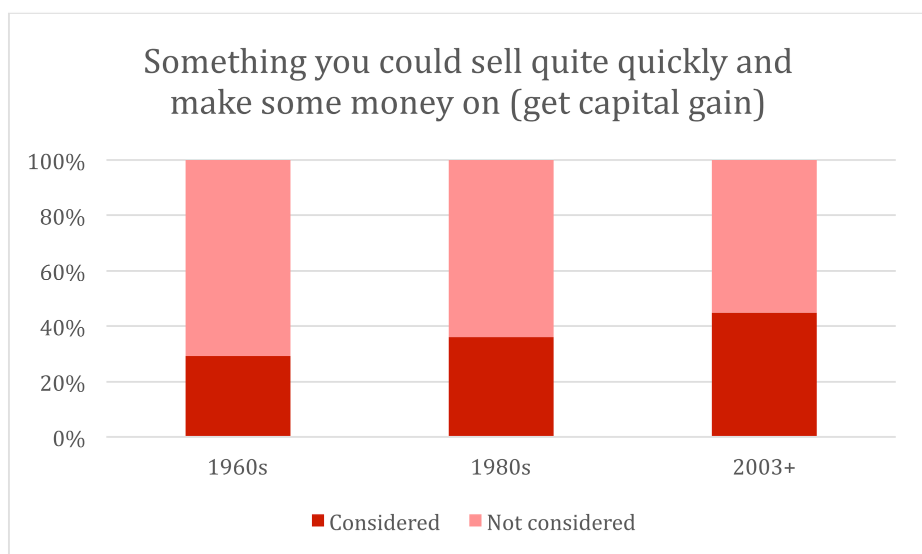












Conclusion

It is increasingly difficult for first home buyers to enter the market because of significant house price increases. House price increases, however, are internalised in the development and building industry via standard calculative practices and result in higher gross development values. In competitive markets, the use of residual land valuation means that reducing costs (consenting, building, labour and material) will not necessarily reduce new build house prices coming to market. It may simply increase the amount developers are willing to pay for land.

Higher gross development values reflect developers’ views around what householders are able and willing to pay. A number of dynamics may be at play. Recent first home buyers see home ownership as necessary to their retirement and as a protective asset. Under that logic, there is significant pressure to enter the market and to bid as high as their financial institutions will allow. Once in owner occupation, rising house prices are necessary to increase equity through potential windfall gains and underpin a sense of security around the future. Householders who struggle but achieve home ownership, consequently, have an interest in continued house price increases. Moreover, rising house prices reduces risk for banks with large mortgage books.

These dynamics, which some commentators have referred to as the house price and land price addictions which characterised the global financial crisis, have increasingly attenuated low- and middle-income families’ access to secure affordable housing, challenge the illusion that housing wealth is a viable platform for general social security and are associated with a preoccupation with greenfields building and environmental degradation.[3]

Architecture of Decision-making Strategic Research Area, BBHTC
Programme Leader Kay Saville-Smith, Centre for Research, Evaluation and Social Assessment

1 W. A. V., Clark, 2011, Prices, Expectations and the Changing Housing Market: a Commentary and Discussion, *Housing, Theory and Society*, 28(3): 269f.

2 See D. J. Fields and S. N. Hodkinson, 2018, Housing Policy in Crisis: An International Perspective, *Housing Policy Debate*, 28(1): 1-5 for a recent overview of these dynamics and the relationship to housing policy; R. Forrest and Y. Hirayama, 2015, The financialisation of the social project: Embedded liberalism, neoliberalism and home ownership. *Urban Studies*. 52(2):233-244.

3 In addition to previous references see also L. Murphy and M. Rehm, 2016, Homeownership, asset-based welfare and the actuarial subject: Exploring the dynamics of ageing and homeownership in New Zealand in N. Cook, A. Davison and Crabtree, L. (eds) *Housing and Home Unbound: Intersections in Economics, Environment and Politics in Australia*, Oxford, Routledge: 39-55; M. N. Peterson, T. R. Peterson, and J. Liu, 2013, *The Housing Bomb: Why Our Addiction to Houses Is Destroying the Environment and Threatening Our Society*, John Hopkins University Press, Baltimore; S. Smith and B. A. Searle (eds), 2010, The Blackwell Companion to the *Economics of Housing: The Housing Wealth of Nations*, John Wiley, Chichester.