High Development Land Prices and the Realities of Urban Property Markets

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Introduction
The current debate about high development land prices should end with a solution to a problem that has dogged this country since the introduction of formal planning in the 1960s. Then, as now, the spectacular transfer of wealth to particular landowners on foot of planning decisions generated a sense of injustice about a system that was supposed to work in the interests of the state as a whole. Most people have an instinctive feeling that any law causing the transference of vast wealth for little or no effort or input by the recipient is simply and plainly wrong. This paper is intended as a contribution to this debate. It draws on the residual land price theory and sees high development land prices as an unintended effect of our planning system and not a cause of high property prices.

As a starting point the paper looks at some of the circumstances around the introduction of formal land-use planning to Ireland in the early 1960s and suggests that the system of planning in Ireland was not informed by a sufficient understanding of urban, property and, more particularly, housing economics. This it is argued remains the case and is at the heart of the difficulties with high development land values.

It further suggests that property and housing markets have characteristics that set them apart from other markets but that in Ireland economists, planners and other policy makers do not adequately appreciate these. A number of characteristics are then discussed by way of illustration. The paper goes on to suggest that as a result the quality of government intervention in land and property markets is likely to be poor and that policy instruments and legislation used to regulate land and property markets are often flawed.

With that in mind the paper then focuses on development land. It suggests that the Planning Act 2000 is impaired in that it prevents local authorities capturing the wealth they create by providing infrastructure and that this is the root cause of the problems associated with high development land prices.

A specific approach is then proposed to remove the suggested impairment. This is based on a concept that sees development land as a product of humankind and not the bounty of nature. It is argued that the concept of development land underlying the implementation of the 1963 Planning Act owed much to inherited agrarian traditions and much of the debate about methods of dealing with high development land prices takes that understanding as a given. This paper argues that we need to re-conceptualise development land in a way that
is more suited to an urban and industrialised society and if this were done, a solution to problems with high development land problems could be implemented. Finally with this in mind, a specific proposal is made to amend the Planning Act 2000 in a way that could act as a tipping point to achieve substantial reform.

The Introduction of Formal Land Use Planning to Ireland
The precursor to the 2000 Planning Act was the Planning Act of 1963. It removed the right to develop from the bundle of legal rights that comprised the ownership of landed property. It also provided complex administrative machinery for returning these rights to selected landowners based on development plans. In effect, the right to develop property was taken from all landowners and concentrated in particular areas. These were selected on the basis of proper planning, and development rights were then returned only to particular landowners by way of a grant of planning permission. To put it simply, wealth in the form of property development rights was taken from many and given to few for the benefit of all.

Curiously, for a state where the dominant approach to land, economics and politics was traditional and conservative, a radical approach to the management of urban development and expansion was enshrined in the planning process. Perhaps the explanation for the acceptance of this can be found in the notion that rather than allowing free market solutions the new planning system dealt with the allocation of land resources mainly by public administration, albeit overseen by a democratic decision at a policy level when enacting a development plan. It did this on the basis that wealth was transferred out of the public sector and into the hands of particular individuals, many of whom were farmers and others with political power.

Since the 1960s, urban development has taken place within a framework laid down by the 1963 Planning Act. But this Act did not address the issue of whether those from whom development rights were taken should be compensated, nor the related question of what to do about the increase in some land values occasioned by concentrating development in selected areas.

Furthermore, the Act has been implemented by planners who, to put it at its least, lacked a confidence that property markets are capable of achieving an efficient and effective pattern of land use and development. They saw the role of planning as overcoming market forces which would otherwise produce a poor quality and inefficient built environment.

A lack of interest, or perhaps even a distrust in the functioning of property markets, may be partially explained by an absence of development and business experience among those who chose planning as a career. Alternatively, as the dominant understanding of land and property at the time of the introduction of planning was rooted in rural and not urban life, where urban economics would be experienced by people in business but not in power, the effect on land values was not fully realised by politicians and policy makers. More than likely it was probably some combination of both of these and other factors.

In any event, the Irish planning system has produced, particularly in the Dublin area, a land use pattern of great inefficiency. Arguably it is a pattern that is much worse than might have evolved if formal land-use planning had been more narrowly focused on major roads,
railways and sewers coupled with blunt and prescriptive formulae for zoning and development density.

**Planning Needs to Work with Property Markets**

To provide for a more efficient, effective and sustainable land use pattern in our urban areas in future, planning needs to work with property markets. To do this, however, property markets need to be understood rather than be seen as posing a challenge for planners and other policy makers to overcome.

Certain characteristics of property markets need to be better understood by policy makers in Ireland if this is to be achieved. Spatial, urban and property economics is, however, not a particularly popular specialism within the wider field of economics and many economists, planners and others, may not have a sufficient understanding of the particular insights this body of knowledge can provide.

Indeed, for many professionals involved with regional and urban planning, urban economics, and the operation of housing markets in particular, appear to have been only of passable interest in the past. The changes brought about by the 2000 Act are a welcome change in that they focus the attention of planners on housing markets and the need to ensure that sufficient development land is available for housing during the currency of the plan.

When attention is given to property and housing markets many of those in the planning process bring to their analysis a view about the operation of markets informed by traditional economic analysis. But this may not be appropriate for property and urban land which have particular characteristics, often not fully appreciated. Indeed the public and particularly local authority councillors who are the ultimate decision makers about land use and property development, are quite often not adequately informed about how property and urban land markets function. This is evident from recent debates about development levies applied under Section 48 of the 2000 Act where the argument that these will simply put up house prices is often advanced to support a position against them.

Furthermore, many debates about development plans and rezoning are skewed by considerations about the effects of planning decisions on the private wealth of individuals who own the affected land. A consequence of a lack of a more sophisticated understanding of how property markets work is that decisions flowing from debates about planning issues are not likely to produce optimum results for the community. Clearly there is a need for a greater level of understanding of the particular characteristics of land and property markets. By way of illustrating this the following characteristics of property markets are worth discussing in more detail.

**Property Markets are Cyclical**

It can be said of course that all markets are cyclical but in the case of property, cycles can endure and be more amplified than is the case with other markets. It is a fundamental characteristic of property markets that they are prone to periods when prices are either too high or too low. In the case of housing it seems inevitable that when prices are high those at the bottom end of the market will be priced out and alternatively when prices are low supplying those at the bottom end of the market will not be profitable. It follows that direct provision of accommodation to some at the lower end of income levels will be inevitable,
particularly in large urban areas where the available accommodation will be priced out of reach even of those who should be able to house themselves given their income. We see this process at work in the UK recently where policy instruments catering for what are called ‘Key Workers’ are mooted for London.

It is true, as is often suggested by economists commenting on the market, that in the long run the market will succeed in bringing supply and demand for housing into some sort of equilibrium. In the case of housing, however, the long run might take longer than a childhood, too long for the social needs of many in the community. If ever J.M. Keynes’s point that in the long run we are all dead was a suitable warning to economists, it is in the case of housing markets where the need as opposed to the demand for housing can be crucial for many.

The fact is that the market will not supply all with their accommodation needs and in suitable locations. We may conclude that a more sophisticated approach to housing economics is needed to deal with the particular difficulties in the housing market.

**Development Land and the Laws of Supply and Demand**

For a market to work efficiently, sellers ought not to be able to unduly influence trading, either by virtue of there being a relatively small number of suppliers or by being able to control the rate and timing of supply. A moment’s reflection on the development land and housing markets in the Dublin area should serve notice that the principles of free market economics may not apply smoothly within the framework of our existing planning laws. Again, supply and demand cannot be relied on to work in the normal way and produce anything approaching an optimum solution to difficulties with prices and distribution in development land markets. A more sophisticated and informed understanding is required.

**Property Markets are Dual Markets**

It is crucial to appreciate fully that property markets operate on two levels. They are both consumer markets and investment markets. The availability of finance and the interest of investors can exert an extremely powerful influence on both activity levels and on prices of property. Quite often the rhythm of a buoyant investment market rhymes with the demand from those looking for accommodation and the two markets reinforce each other, amplifying cycles and driving prices either too high or too low. Property markets are therefore much more complex than might be appreciated if they are looked at from the perspective of accommodation demand only.

**Property Markets are Local Markets for Unique Properties**

Property markets in different geographical locations are very distinct and each parcel of property is unique. Property markets are essentially local and not national nor international markets. Hence national policies can have profoundly differing effects on local or regional markets. This makes devising policies at national level for local situations very difficult as is evident from current difficulties with one-off houses in rural areas.

**The Influence of Taxation**

Property markets, and particularly house markets, are hugely influenced by national and local tax regimes. In many countries, tax regimes are biased in favour of home ownership. Ireland’s tax system is particularly favourable to the ownership of a principal private
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residence and when coupled with a sophisticated financial services industry which has products allowing people to borrow on favourable conditions or to withdraw equity, the capacity and propensity to buy and hold property is enhanced. The characteristics of property markets are heavily dependent on tax policies. This makes price and market comparisons extremely difficult. Therefore when drawing conclusions from what happens in one location care should be taken about what can be done to solve housing and planning problems in another.

Research Statistics are Poor
Statistics about property markets are mostly deficient, hence research and knowledge about how these markets function is poor. Meagre information is often distorted by rumour, little agreement about the definition of common terms, and a lack of precision in the language used in discussion. This is also true for most EU countries, some of which have very poor information indeed. We simply do not understand the operation of our property markets to a sufficient degree to allow them to be manipulated with confidence. This means that government intervention is often poorly targeted and can have unintended effects. This also renders comparison or identifying solutions from the experience in other countries problematic. Furthermore it reinforces arguments that the government should not interfere in property markets.

Putting these together we can see that land and property markets are a special case and have characteristics that mark them out for separate study. Heretofore housing, planning and taxation policies have not been sufficiently informed by a proper understating of these characteristics nor by sufficient study of the effects of planning on property markets. So, if property and housing markets are not sufficiently researched nor understood and decisions are being taken in the absence of good information, it is not surprising that the quality of government intervention is likely to be poor. Also more than likely, policy instruments used to regulate activity in property markets will be flawed. It should not be too surprising, therefore, that our planning system has serious impediments, or indeed flaws, when considered from a property market perspective.

The most significant instrument now used to regulate property markets is the 2000 Planning Act which regulates the flow of development land to the market. This is a successor to the original 1963 Act which was framed at a time when the common understanding of the functioning of urban areas reflected the society and economy that existed at the end of the 1950s and the early 1960s, as noted earlier.

This legislation provides the regulatory regime within which land and property markets now function. In a sense, this legislation sets the rules for the operation of the market. If this results is a situation where development land prices are exceptionally high and present an impediment to the provision of housing and infrastructure, then those seeking solutions to those problems should first consider whether the principles underpinning legislation and the way it is being implemented are at fault. They need to question whether planning procedures are suitable from a perspective of urban, property and housing economics.

Understanding Property Economics
The starting point for this should be an understanding that in a buoyant urban property market, the value of development land is a result of high property prices, not the cause.
Although this appears to run against common sense and intuition, it is a key insight drawn from academic literature on spatial and urban economics and allows a greater understanding of the operation of property and development land markets. Indeed this resonates with many professionals in property markets. It is worth elaborating somewhat on this.

In urban markets, property developers are price takers. They sell their product at a price determined in a market and work back from there to arrive at the price they can pay for the raw material they need which is land. In the early phases of property booms the price developers can obtain for their product goes up much more rapidly than the cost of materials and labour needed to build it. Hence they are empowered to pay a higher price for the required land. Far from pushing up the price of property the price or value of development land is pulled up by rapidly increasing property prices. If there is a shortage of available opportunities for developers to buy land and supply the property market they will bid against one another for the available supply. Where there is a system of formal land-use planning the supply of development land will be restricted.

The challenge in drawing up a development plan is, of course, to identify accurately the amount of land to be zoned for development over the period of the plan, six years under the Planning Act. This is a difficult task given that getting a plan adopted takes time and the groundwork must be done some time in advance. Consequently, planners will be faced with the most difficult task of estimating the amount of accommodation needed in their area for the next seven to eight years.

Now, given the relative paucity of information about how property markets work coupled with the difficulty of getting economic forecasting right more than, say, a couple of years out, it is entirely likely that the estimates will be out of pace with what actually happens in the market. This is an inherent defect in planning and will not be much of a problem if too much land is zoned. If too little is zoned, however, a major shortage of development land will emerge.

This shortage will prompt a reaction among developers who will need to keep their employees occupied continuously and cannot afford to have a fallow period when they do not have land to build on. Where there is a prospect of a shortage of development land, developers will act in a way they see as a prudent and create a pipeline of development land for themselves by acquiring much more land than they need to meet their immediate requirements. In doing this they may be accused of hoarding but in practice they are stockpiling the raw material they need to stay in business

Planners therefore need to take this into account and zone and service not only that actual amount of land required to provide the estimated accommodation needs of an area, but also enough to allow for the gestation period needed to bring development land to the point where it can be built on. This will be quite long, given the need to apply for permission and survive appeals. A couple of years or one-third of the period of the plan would not be unusual and this might point to the need to zone and service 50 per cent more than might otherwise be estimated.

If planners do not take this into account, the resulting shortage will force developers into competition with one another and promote the inevitable speculation that accompanies
shortages of any commodity. In this, development land is no different from other things traded in markets. In short, planners need to zone sufficient land to make the market for development land work as efficiently as possible and not just the amount needed to provide accommodation for the duration of the plan.

Providing services and the other infrastructure to support development, however, costs money. When a newly developed property is bought the price paid reflects the fact that the property is connected to services and is supported by the surrounding infrastructure. The purchaser is paying for it but the local authority which provides these gets most of the funds needed from other sources, usually central government. Section 48 of the 2000 Planning Act now provides a mechanism whereby some of the cost can be recouped by way of development charges. But is this appropriate and sufficient?

**Paying for Infrastructure**

An important concept to be understood when discussing property markets is that it is a market in legal rights to property and not a market for land and buildings. But here there is a need for great caution. When discussing property rights, definitions of what constitutes the bundle of legal rights that identify the ownership of landed property are not well understood and are rooted in popular understandings of property rights which may be inappropriate or ill considered and are often confused.

Development land can be thought of as an amalgam of three separate property rights. The rights to occupy and use land, the right to develop or change use and the right to connect to infrastructure. A landowner holds the first of these and should be entitled to the full constitutional protection for that right. The other two are transferred to the landowner by local authorities through the planning system. They are, however, valuable property rights in themselves. But, crucially, they are not inherent in the legal right to land *per se*. To exist, they require economic effort on the part of the local authority.

When a local authority transfers these rights, development land is created and it is this that attracts spectacularly high prices on the market. But the landowner could be charged for these. The ‘price’ for doing so should be the market value of the property right created by the local authority (the right of access to infrastructure and the grant of permission to develop). Unfortunately, the planning system induces local authorities to transfer the grant of permission to develop for free and the right to connect to infrastructure at cost, thus making a gift of a valuable property right. The impediment or flaw here is that legislation prevents local authorities from capturing the wealth they create by the provision of infrastructure. In effect, wealth owned in common by a community is transferred to a private individual. There is no balance of individual rights and the rights of the common good here.

This should become clear if we come to think of the right to connect to services as a property right. Many do not and seem to hold the view that infrastructure provided by a local authority is analogous to common land. It is available to all and a basic right exists to access it. This ignores the fact that it takes effort and resources to create what in the case of infrastructure is an asset with an economic value.

Another flaw with the planning system is that there is no mechanism to bring land to development. Planners can draw up plans but they have limited powers over their execution.
In this they are impotent. Development plans rely on the individual decisions to bring land and new houses to the market. But landowners can withhold land from the market for reasons that suit them. Even worse, they are given an economic incentive to stockpile land. The notion that the increase in value that from rezoning should provide a sufficient incentive to bring development land to the market is extremely naïve and displays a lack of understanding of land-use economics.

Furthermore and as an aside it is worth noting that this analysis suggests that recent reforms in the form of Part V of the Planning Act 2000 are also flawed. Through this the supply of the affordable and social housing sector is linked to the rate at which the private sector is supplied by entrepreneurial developers. To put this another way, in future, the supply of social and affordable housing will largely be determined at the convenience of house-builders. This is not a desirable situation and will create difficulties if there is a downturn in the property market. Although the Part V provisions can make a significant contribution to the provision of affordable housing, it is unlikely to be sufficient to address the shortage of housing at the lower end of the market, particularly in Dublin, even in good times.

These impediments or flaws in the planning system have created difficulties with the supply and price of development land since the system was instituted in the mid-1960s. Of course there have been attempts to study the situation and ameliorate the problem since then. Two of these are the Kenny Report (1973) and the Report of the Oireachtas Joint Committee on Building Land (1985). But there are very serious administrative and procedural problems with the concept of compulsorily acquiring land as suggested in the Kenny Report. In any event this amounts to using a sledgehammer to crack a nut and could create an unresponsive public-sector monopoly in the supply of development land.

A solution of a kind to the problem of windfall profits from dealing with development land was adopted following the Report Joint Oireachtas Committee on Building Land. This was to apply capital gains tax at a rate of 60 per cent to development land. Unfortunately this was removed in recent years.

Yet again, when proposals are suggested to deal with the issue of the consequences of high land prices, the Constitution is put forward as an impediment. This is a common theme echoing through the resistance to dealing with the problem.

The question of the constitutionality of tackling the issue of high land values is a distraction. We would do better to seek a solution based on a less sentimental definition of the bundle of legal rights that comprise development land, separates these rights out and allows local authorities to charge appropriately for the right of connection to infrastructure.

As noted above, infrastructure is created by activities of local authorities and the right to connect to infrastructure is not inherent in land. Even now, local authorities have the power to charge for this. But in the 2000 Planning Act, the statutory foundation for this charge is based on cost. (In fact the Act says that in determining development contributions a scheme shall 'have regard to the actual estimated cost of providing specified infrastructure'.) From the arguments above it would follow that these contributions should be based on an
appraisal of the financial benefit or the worth of the right to access infrastructure and not the cost.

There are few circumstances where a party to a transaction is impelled by legislation to supply a valuable right to another party at cost. But our planning legislation does just that. The owner of the raw material in a production process (the landowner) is allowed to compel the owner of a transforming technology (infrastructure) to provide this at cost. The resulting product (development land) is sold on the market at a high price; much higher than the value of the property rights.

There is a further twist in favour of the owner of the raw material. The owner of the technology also limits the amount of raw material coming to the market. It is no wonder that the price of land is so high. Planning legislation structures the market to the benefit of landowners.

But this can be changed easily. A great deal could be achieved if Section 48(3)(b) of the Planning Act 2000 were changed. This section specifies that the planning authority should, when devising a scheme for development contributions, have regard to the actual estimated cost of providing public infrastructure and precludes taking into account the benefit accruing from existing development.

This should be changed to allow the planning authority to have regard to the additional amount that would be paid for the land if it were sold with the benefit of a right to develop in accordance with the development plan, over and above that amount that would be paid for the land if that right were not available.

There is also a need to change S48(1) which confines the planning authority to basing its contribution scheme to the area of the planning authority. A development on the boundary of two planning authorities would benefit from works carried out in both areas.

In addition, a power to rebate the contribution on a sliding basis should be included if the land is developed in accordance with a schedule set out in the plan.

These amendments would give the planning authority explicit power to capture the value created by their work. Essentially it should mean that development contributions should be closer to the difference between agricultural or existing use values and development values. It would transfer hundreds of millions of Euro to local authorities and provide some resources for infrastructure and social housing. What might be called ‘raw-land values’ would be reduced. When land is compulsorily acquired, the basis of compensation would remain as it is, the market value of the land acquired, but this would be at those raw-land values.

It is worth, for a moment, reflecting on the language used in the Act. The phrase ‘Development Contribution’ itself implies that the practice of providing access to infrastructure for free is only to be modified by a contribution scheme. A right of access to infrastructure is implicit. There is no intention to make a landowner pay the economic value of this. This approach is symptomatic of a lack of appreciation of economics pervading the thinking of those informing planning legislation.
Of course, a change to the Planning Act 2000 on the lines suggested could not be introduced as the proposition that development charges will not put up the price of property is not widely accepted. Unless there is a real and profound change in the popular understanding of the economics of property and housing markets, development charges will continue to be seen as a cost to the buyer of property and resisted. Achieving this is the real challenge to solving the problems associated with high development land prices.